WALL STREET PREP CORE MODELING COURSE

Accretion/Dilution (M&A) Modeling

CASE STUDY: APPLE, DISNEY

Mergers & Acquisitions Modeling

Introduction

1

The players in M&A

- Buyer & seller
  - Business development, Management & board, Shareholders
- Investment bankers
  - Accounting, Tax & legal, Regulators

The role of the investment bank in M&A

- Advice on optimal terms & structure
- Access to capital
- Finding buyers/sellers
- Most common types of IB engagements
- Buy-side engagement
- Sell-side engagement
- Fairness opinion

Work often begins long before a deal is in play

- Except for hostile transactions, deals are a product of discussions between managements which can take a long time
- Investment banks are often pitching M&A ideas
  - Cultivating relationships (senior bankers)
  - Pitchbooks & modeling (junior bankers)

Buy-side process and timeline

- When the client is the acquirer, the M&A process can roughly be broken out into four stages:
  - Assessment
  - Contacting targets and valuation
  - Pursuing the deal and due diligence
  - Definitive agreement and closing

Buy-side process and timeline

Period 1 *4-8 weeks*	**Period 2** *4-8 weeks*
Preliminary Assessment	Contacting Targets & Valuation

• Review competitive landscape ☺
• Identify potential targets ☺
• Define acquisition timetable
	• Contact candidates
	• Negotiate NDA (confidentiality agreements)
	• Perform preliminary target valuations: ☺
	    • FSM and DCF
	    • Trading & transaction comps
	    • LBO & M&A modeling

☺ **= A lot of junior banker work**

Buy-side process and timeline

Period 3 *4-10 weeks*	**Period 4** *4-10 weeks*
Pursuing the Deal & Due Diligence	Definitive Agreement & Closing

• Letter of intent (LOI)
• Complete valuation analysis ☺
• Business due diligence ☺
    • Company and industry analysis
    • Overview of products and services
    • Site visits
• Financial due diligence ☺
    • Financials review
    • Financial statement projections
• Tax returns, legal
	• Finalize due diligence
	• Prepare, negotiate and execute definitive agreement
	• Secure financing
	• Prepare and make required SEC filings
	• Shareholder and regulatory approvals
	• Transaction close

☺ = **A lot of junior banker work**

Sell-side and divestiture process and timeline

- When the client is the seller, the M&A process can roughly be broken out into four stages:
  - Assessment
  - Marketing
  - Due diligence
  - Negotiation and closing

Sell-side and divestiture process and timeline

Period 1 *4-6 weeks*	**Period 2** *4-6 weeks*	**Period 3** *4-6 weeks*	**Period 4** *6-8 weeks*
Preliminary Assessment	Contacting Buyers	Meetings with Buyers	Negotiation / Closing
• Define strategy • Review landscape • Identify buyers • Define timetable • Prepare CIM[1] & teaser ☺	• Distribute Teaser • Exchange NDAs[2] • Distribute CIM • Receive IOIs[3] • Narrow buyer list • Provide access to company data (data room) ☺	• Meet with interested buyers • Answer follow-up diligence requests • Receive LOI[4]	• Negotiate final terms • Finalize due diligence • Definitive agreement • Legal docs/SEC filings • Deal close/funds flow

☺ = A lot of junior banker work

[1]The CIM is also called CIP (confidential information presentation) or OM offering memorandum and IM (information memorandum)
[2] NDA = Non Disclosure Agreement
[3] IOI = Indication of interest
[4] LOI = Letter of intent

The role of the junior investment bankers in M&A

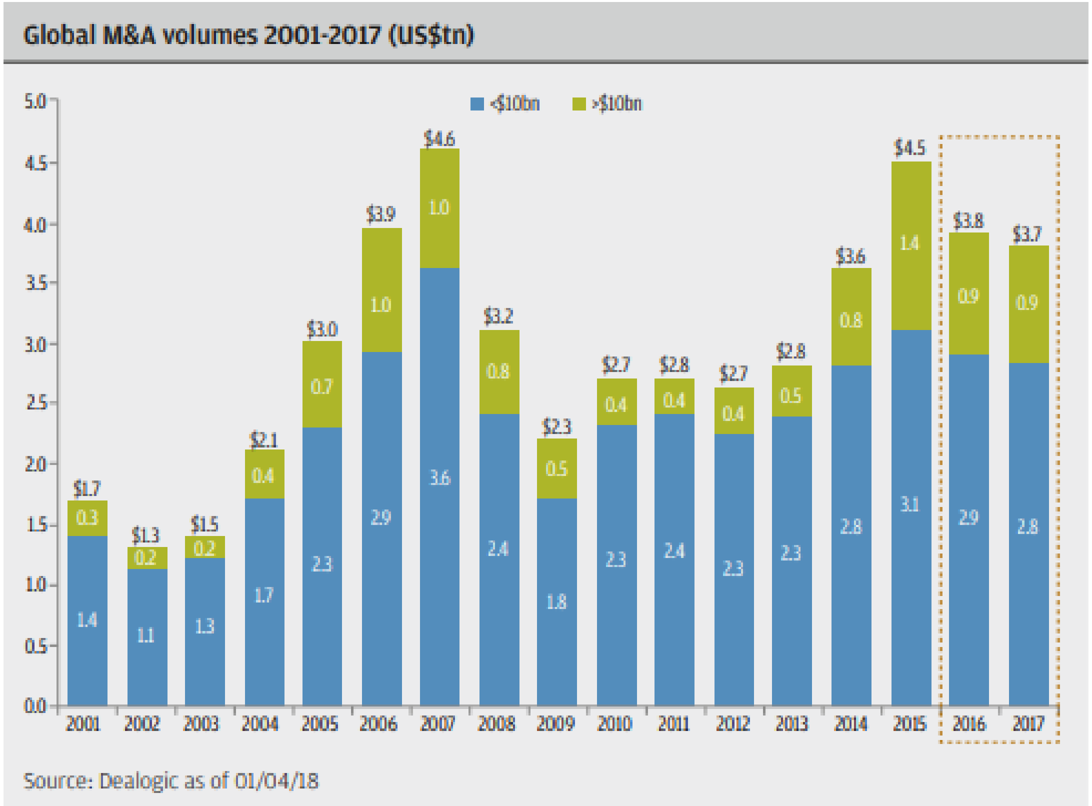
- Presentations
  - Pitchbooks & live deal decks (both buy-side & sell-side)
  - Offering memorandum (OM) aka CIM (sell-side)
  - Fairness opinions
- Due diligence
  - Financial analysis
  - Running a data room (sell-side)

Our focus

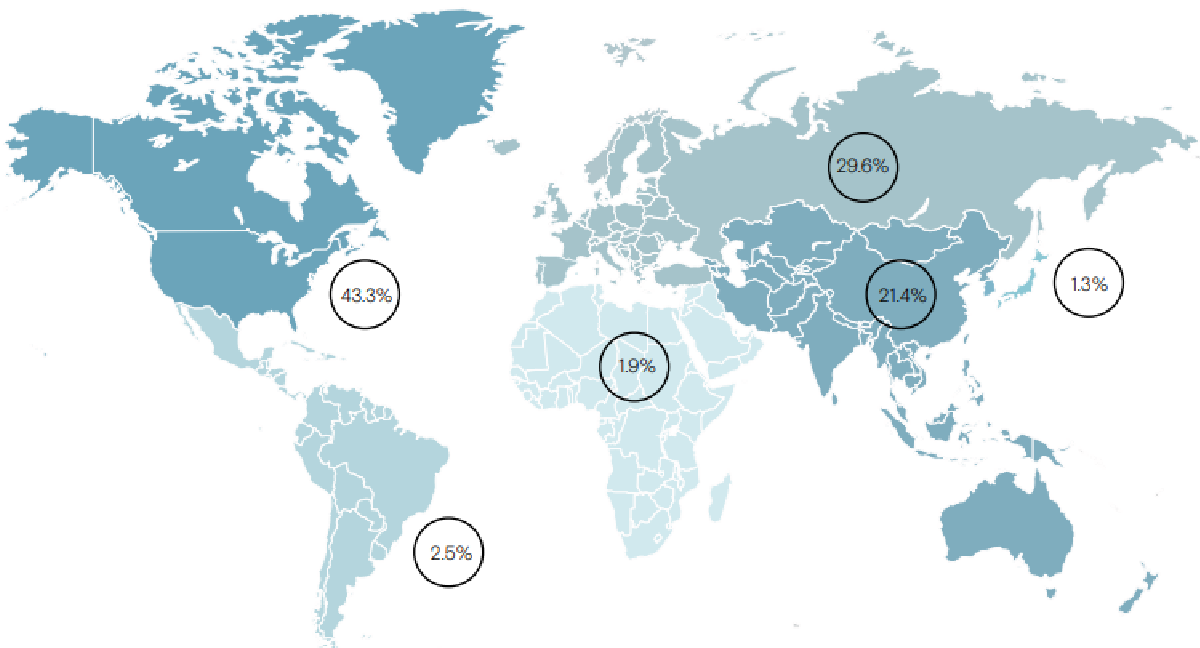
The technical analysis (modeling) that goes into decks, pitchbooks, and fairness opinions

State of M&A

- 2017 M&A volume pulled back from 2007/15 peaks, but still high compared to prior years



United States accounts for nearly 45% of global M&A



Global M&A	US$ 3.15tn	-3.2% vs. 2016
Cross-border	US$ 1.33tn	-0.4% vs. 2016
Top sector: EMU	US$ 543bn	-7.7% vs. 2016

The % values on the map indicate market shares in global M&A

North America	**US$ 1.36tn**	**-13.4% vs. 2016**
Inbound	US$ 263.1bn	-23.6%
Outbound	US$ 363.1bn	+15.8%
EMU	US$ 306.8bn	-12.2%
Latin America	**US$ 80.1bn**	**+3.6% vs. 2016**
Inbound	US$ 49.3bn	-5.3%
Outbound	US$ 7.6bn	-32.6%
EMU	US$ 26.5bn	-33.4%
Europe	**US$ 929.3bn**	**+14.0% vs. 2016**
Inbound	US$ 347.9bn	-20.2%
Outbound	US$ 245.6bn	-10.9%
Ind & Chem.	US$ 147.3bn	-11.1%
MEA	**US$ 59.4bn**	**-34.2% vs. 2016**
Inbound	US$ 51.1bn	-22.7%
Outbound	US$ 35.5bn	-42.0%
Ind & Chem.	US$ 21.5bn	+122.6%
APAC (ex. Japan)	**US$ 673.5bn**	**+4.8% vs. 2016**
Inbound	US$ 107.7bn	+21.9%
Outbound	US$ 114.7bn	-54.1%
TMT	US$ 121.7bn	+194.0%
Japan	**US$ 40.1bn**	**-36.4% vs. 2016**
Inbound	US$ 21.3bn	+102.9%
Outbound	US$ 59.1bn	-36.7%
Technology	US$ 13.3bn	+143.1%

mergermarket.com

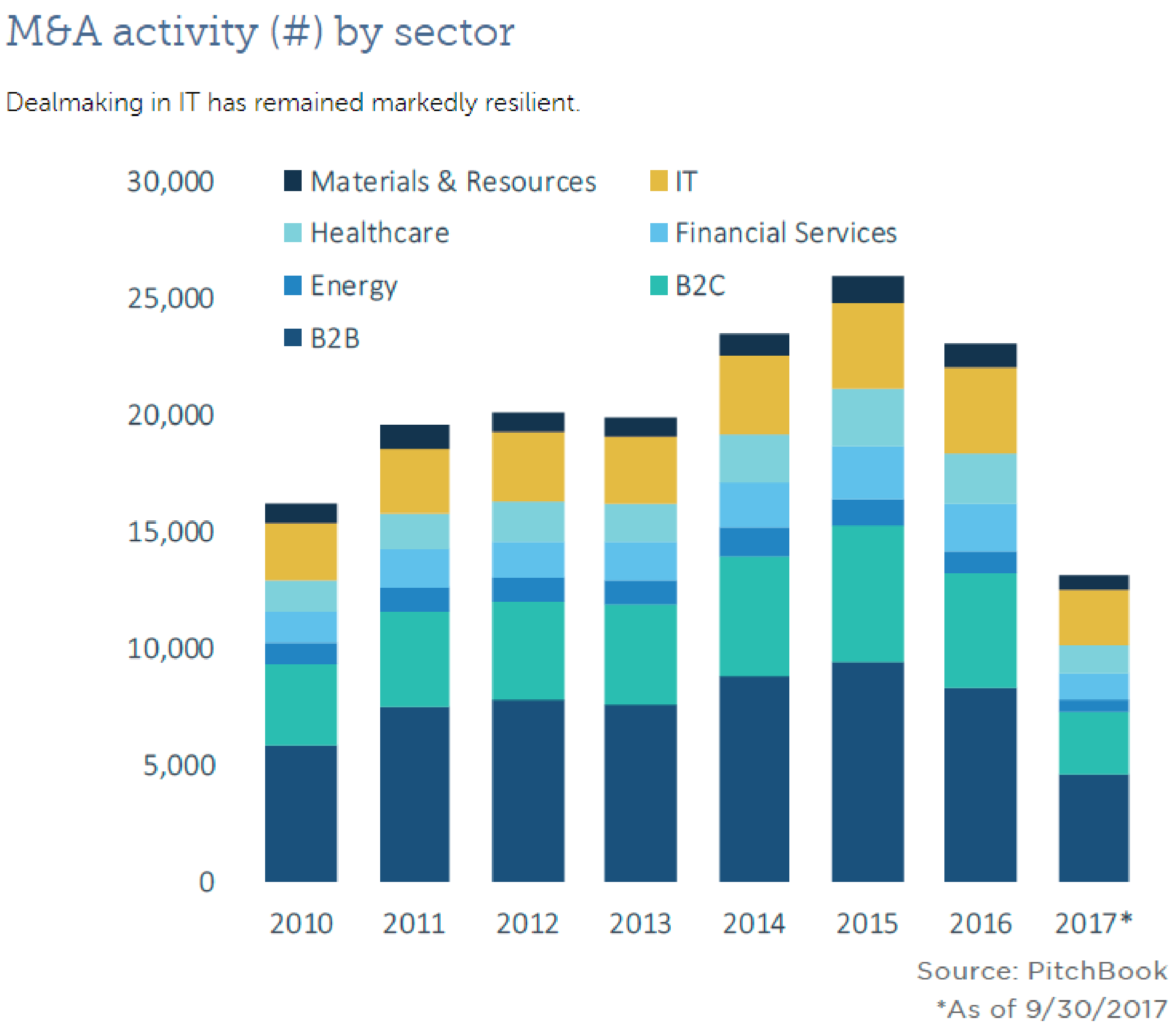
League tables

Financial advisor league table by value

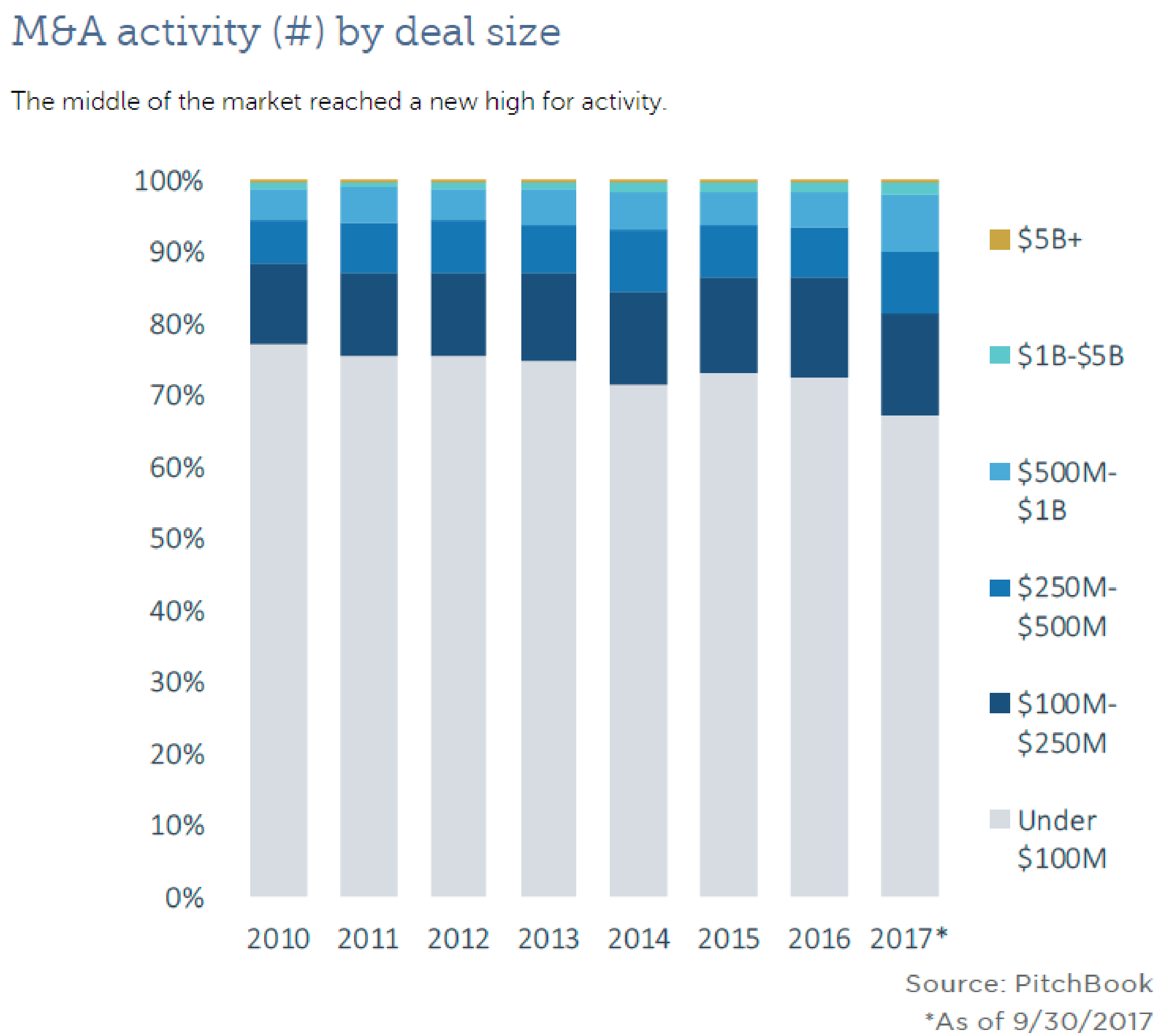
Ranking			2017		2016		Regional ranking comparison					
2017	2016	Company name	Value (US$m)	Deal count	Value (US$m)	% Value change	Europe	US	Asia Pacific	Japan	Middle East & Africa	Latin America
1	2	Goldman Sachs & Co	878,121	315	844,947	3.9%	1	1	1	1	1	4
2	4	JPMorgan	702,197	313	658,040	6.7%	3	2	4	4	5	3
3	1	Morgan Stanley	633,394	270	881,274	-28.1%	4	3	2	3	4	7
4	3	Bank of America Merrill Lynch	481,618	191	699,061	-31.1%	2	5	5	7	7	1
5	5	Citi	468,440	200	559,947	-16.3%	7	4	7	12	2	8
6	10	Lazard	447,612	235	280,088	59.8%	5	7	12	8	15	11
7	11	Deutsche Bank	335,145	131	268,341	24.9%	8	9	9	21	22	27
8	6	Barclays	332,465	165	496,107	-33.0%	15	6	26	32	20	10
9	7	Credit Suisse	319,866	203	465,790	-31.3%	9	10	14	9	11	13
10	9	UBS Investment Bank	279,658	159	301,828	-7.3%	10	12	3	15	13	18
11	14	Centerview Partners	263,801	43	190,375	38.6%	17	8	128	30	8	-
12	12	Rothschild	250,612	321	253,797	-1.3%	6	20	8	28	3	20
13	8	Evercore	231,333	139	321,141	-28.0%	32	11	20	6	77	24
14	21	Jefferies	144,336	155	89,717	60.9%	21	14	17	17	18	147
15	29	BNP Paribas	136,706	96	58,598	133.3%	11	34	13	82	25	19
16	17	Perella Weinberg Partners	123,735	31	117,337	5.5%	16	15	-	154	45	-
17	22	Guggenheim Partners	113,591	29	80,996	40.2%	117	13	603	-	29	-
18	25	Macquarie Group	111,757	89	64,213	74.0%	14	17	16	19	24	132
19	15	Allen & Company	100,544	21	146,301	-31.3%	293	16	158	-	165	104
20	19	HSBC	95,257	64	91,769	3.8%	18	23	10	48	12	36

Source: Mergermarket

State of M&A by sector

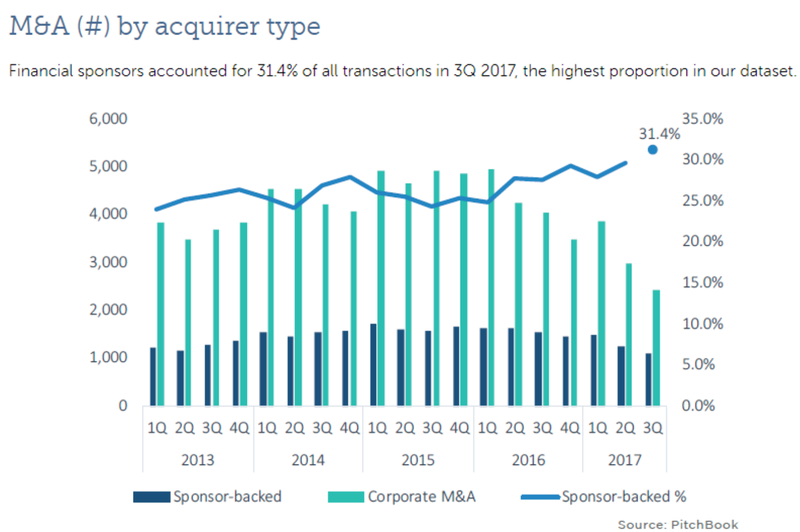


State of M&A by deal value



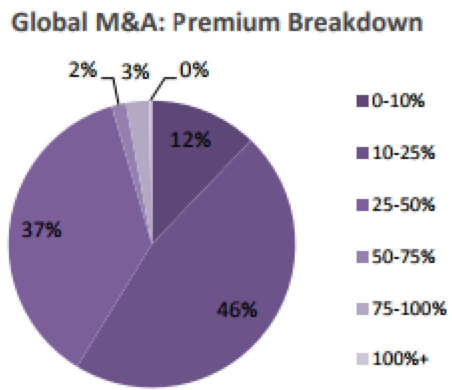
Corporate buyers (strategics) vs. private equity (PE)

- Both strategics and PE are involved in M&A.
- PE deals don't get the benefit of synergies, but tend to have greater efficiency & focus on exit strategies
- PE-backed M&A has ranged from 20-30% of total M&A

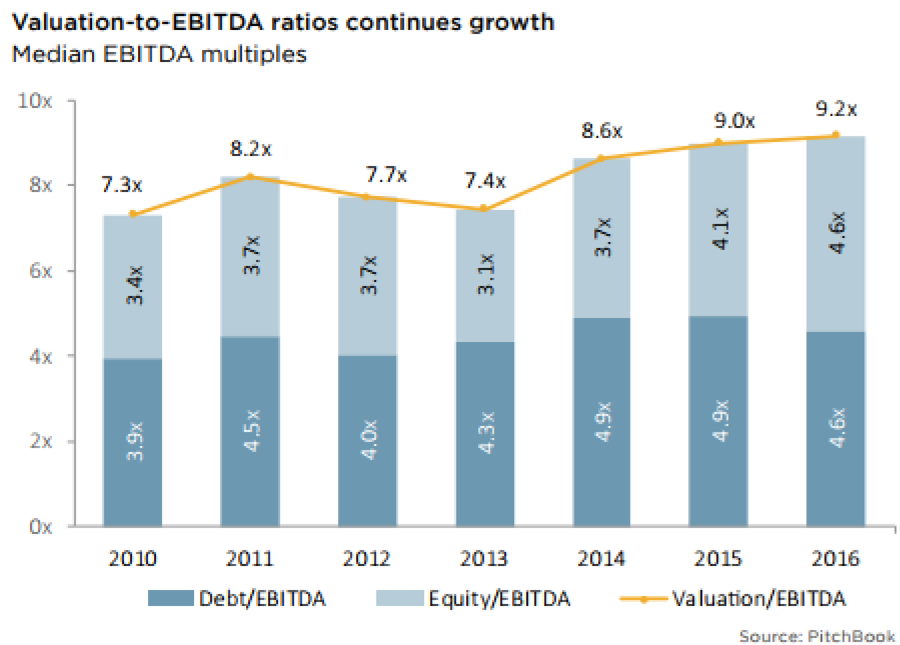


Multiples and premiums

- Valuation multiples continue to be historically high, though some signs of pullback in sponsor backed deals
- 83% of deals had premiums between 10-50% in Q1 2017



For Global M&A in 2016. Source: Bloomberg



What does an M&A model show?

- Impact on financial statements (accretion / dilution, etc.) at various deal assumptions

- Implications to valuation and credit ratios

- These conclusions are used to evaluate:

- Pricing capacity of Acquirer to pay for Target

- Optimal form of consideration (cash, stock, other securities, combination)

- Accounting and investor considerations

Mergers & Acquisitions Modeling

Accretion / Dilution Basics

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Accretion / Dilution

- One of the core models M&A professionals build when analyzing an acquisition is the accretion/dilution model.
- An acquisition is accretive when the combined (pro forma) EPS is greater than the acquirer's stand-alone EPS.

Accretion dilution

- Suppose analysts expect P&G's EPS to be $3.05 next year
- If they were to acquire Colgate and it is determined that the combined (pro forma) EPS next year would instead be $3.10 the deal is considered to be **$0.05 accretive**
- An acquisition is dilutive if PF EPS < standalone EPS, and break-even when PF EPS = standalone EPS

Accretion / Dilution

Hologic to Acquire Gen-Probe

Creates Leading Diagnostics Franchise Focused on Women's Health

Transaction Delivers Attractive Economics with Strong Growth and Margin Profile; $0.20 Accretive to Hologic's Adjusted EPS in First Fiscal Year After Close

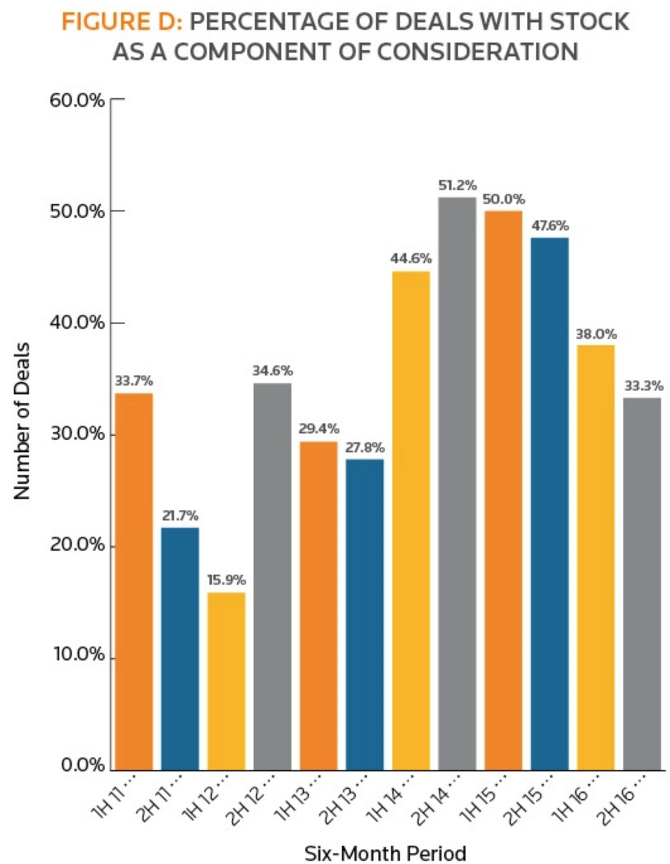
Companies to Host Conference Call at 8:15 AM ET Today

BEDFORD, Mass. and SAN DIEGO, April 30, 2012 /PRNewswire/ -- Hologic, Inc. (NASDAQ: HOLX) and Gen-Probe Incorporated (NASDAQ: GPRO) today announced that their Boards of Directors have unanimously approved a definitive agreement under which Hologic will acquire all of the outstanding shares of Gen-Probe for $82.75 per share in cash, or a total enterprise value of approximately $3.7 billion. The all-cash transaction is expected to be funded through available cash and additional financing of term loans and high yield securities. The transaction is expected to be completed in the second half of calendar 2012.

The transaction delivers a strong growth profile with attractive economics and is expected to be $0.20 accretive to Hologic's adjusted earnings per share in the first fiscal year after close and significantly more accretive thereafter. Hologic also expects the transaction to accelerate top and bottom line growth rates. The combined company expects to realize approximately $75 million in cost synergies within three years following the close of the transaction. In addition, the combined company expects to have strong free cash flows, which will be used primarily to reduce debt with the expectation to return to pre-transaction leverage levels within three years.

Deal consideration

- Acquirers pay for their acquisition by:
- Paying cash
- Issuing stock
- A combination of both (i.e. 50% stock & 50% cash)
- The financing decision carries significant legal, tax, and accounting implications.



Source: Thomson Reuters

Major adjustments to pro forma EPS in M&A

- In a 100% stock deal: The major adjustment to acquirer's EPS will arise because the acquirer must issue a lot of new acquirer stock in exchange for target shares, such that PF shares = acquirer's pre-deal shares + acquirer shares issued in the transaction

- In a 100% cash deal: No new acquirer shares must be issued, but either excess cash or new debt finances the acquisition. This impacts the I/S via incremental interest expense, reducing PF net income and EPS. New interest expense is often the major adjustment in a cash deal

- In a mixed deal: Both adjustments must be made

Accretion / dilution process (100% stock sale)

1. Calculate pro forma net income (PFNI): Acquirer + target net income
2. Calculate offer value: Target offer price x target shares
3. Calculate acquirer shares issued in the transaction: Offer value / acquirer share price
4. Calculate the pro forma shares outstanding (PFSO) = Pre-deal acquirer shares + acquirer shares issued
5. Divide the PFNI by the PFSO to get PF EPS
6. Compare PF EPS against acquirer's stand-alone EPS

Accretion / dilution process (100% stock sale)

- Accretion: When Pro Forma EPS > Acquirer's EPS
- Dilution: When Pro Forma EPS < Acquirer's EPS
- Break-even: No impact on Acquirer's EPS

Accretion dilution exercise I

Assumptions
1. Acquirer purchases 100% of target by issuing additional stock to purchase target shares
2. No premium is offered above target's current share price

	Acquirer	Target	Pro-forma
Share price at announcement	$25	$60	
P/E ratio	10.0x	12.0x	
EPS next year	**$2.50**	**$5.00**	
Shares outstanding	4,000.0	1,000.0	
Net income next year			
Acquirer shares issued			
Offer value (offer price x target shares outstanding)			
Exchange ratio (acquirer shares issued / target shares outstanding)			
Accretion / Dilution ($ per share)			
Accretion / Dilution (%)			

Accretion dilution exercise I

Assumptions
1. Acquirer purchases 100% of target by issuing additional stock to purchase target shares
2. No premium is offered above target's current share price

	Acquirer	Target	Pro-forma
Share price at announcement	$25	$60	
P/E ratio	10.0x	12.0x	
EPS next year	**$2.50**	**$5.00**	$2.34
Shares outstanding	4,000.0	1,000.0	6,400.0
Net income next year	10,000.0	5,000.0	15,000.0
Acquirer shares issued			2,400.0
Offer value (offer price x target shares outstanding)			$60,000.0
Exchange ratio (acquirer shares issued / target shares outstanding)			2.40x
Accretion / Dilution ($ per share)			-$0.16
Accretion / Dilution (%)			-6.3%

Calculating acquirer shares issued
Acquirer shares trade at $25, while target shares trade at $60. Since no premium is being offered to target shareholders (unlikely in the real world), target shareholders will accept 2.4 acquirer shares in exchange for each target share. Thus, acquirer must issue 2,400 shares to purchase 1,000 target shares.

PE ratios determine accretion/dilution in stock deals

- A deal is accretive when a high PE company acquires a low PE company (and vice versa)

Accretion/dilution

- Acquirer expects EPS of $1 next year, with a share price of $5 (PE = 5.0x)
- Target also expects EPS of $1 next year, but with a share price of $10 (PE = 10.0x)
- In a 100% stock deal, Acquirer must issue 2 shares to acquire one target share.
- <u>This deal will be dilutive</u> because 1 Acquirer share equates to owning $1 of Acquirer net income, but Acquirer must issue 2 shares in order to acquire $1 of Target's net income.
- As a result, the incremental benefit of Target net income will not be sufficient to offset the share dilution required to make the deal happen.

Other adjustments

- In the simple example, we just lumped the acquirer and target net incomes together. In reality, before we just lump the two net incomes together, there are several (sometimes very significant) adjustments to net income that will be used in determining accretion / dilution:
  - Acquisition financing
  - Cost savings (synergies)
  - Fees
  - Accounting changes

Acquisition financing

- In our simple example, we assumed 100% stock deal. In the case of a 100% cash (or mixed) deal, recall that excess cash reserves must be used, or the acquirer must take on new debt to finance the acquisition.
- This new borrowing impacts the income statement in the form of incremental interest expense (or forgone interest income), reducing the combined pro forma net income and EPS.
- In fact, the major adjustment to EPS in a cash deal is often the incremental interest expense arising from additional debt issued to finance the deal.

Cost savings (synergies)

- Often the main rationale of an acquisition is to make a significant cut in expenses by eliminating overlapping R&D efforts, closing down manufacturing plants, and employee redundancies.
- Synergies will reduce expenses and thus increase pro forma net income (PFNI) and pro forma EPS (PF EPS).

Fees

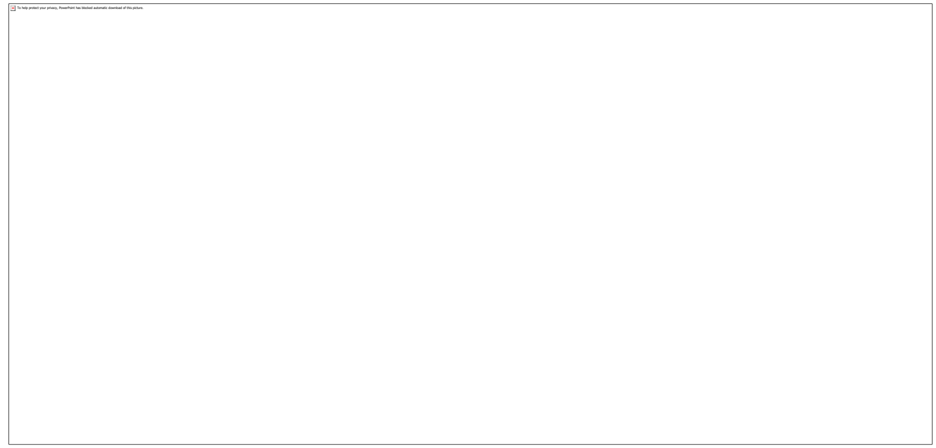
- Investment banking advisory fees, legal fees, and accounting fees: Need to be expensed as incurred on the income statement, reducing PFNI and PF EPS.
- Underwriting fees: When a company borrows debt to finance an acquisition, the fees related to this borrowing are treated differently from advisory, legal, and accounting fees. Underwriting fees are capitalized and amortized over the life of the debt issuance[1]. This creates an incremental amortization expense which reduces PFNI over the term of the borrowing.

[1]Effective 2016, FASB has changed to accounting for financing fees so that instead of being capitalized as an asset and then amortized, they are instead treated as a contra-debt item. The income statement impact is still the same (amortization is recognized over the term of the borrowing) but it is classified within interest expense. To read more about this change at https://www.wallstreetprep.com/knowledge/debt-accounting-treatment-financing-fees/

Accounting adjustments

- Incremental D&A, asset write-ups, write-downs: Target assets like PP&E and intangible assets are written-up to fair market value in a deal.
- Incremental D&A will be recorded, thereby reducing PFNI and PF EPS.
- Accounting adjustment – goodwill: Goodwill created in an acquisition does not impact the IS (at least not immediately).

Presentation of accretion dilution analysis



- Analysis is usually presented using a data table in Excel.
- Since the analysis is done pre-deal, it is rooted in assumptions like the offer price, the form of consideration, and the interest rate on borrowing.
- Should be easy to change key assumptions and to see how those changes affect the accretion/dilution outcome.

Accretion / dilution exercise II

- When ready, open the accretion-dilution-model.xlsx template and complete the 'Exercise' tab
- Check your work in the 'Solution' tab

Mergers & Acquisitions Modeling

Acquisition Accounting & Purchase Price Allocation

3

Acquisition accounting

- An acquisition is viewed as the purchase of target assets and assumption of target liabilities, which are written up to reflect their fair market values (FMV)

Acquisition method

- FASB prescribes that we use the 'acquisition method' to account for acquisitions (FAS141r, FAS 160, ARB 51)
- There is much alignment between U.S. GAAP and IFRS

- If the purchase price is greater than the FMV of the net assets, the excess is recognized as an accounting asset plug called goodwill

Goodwill

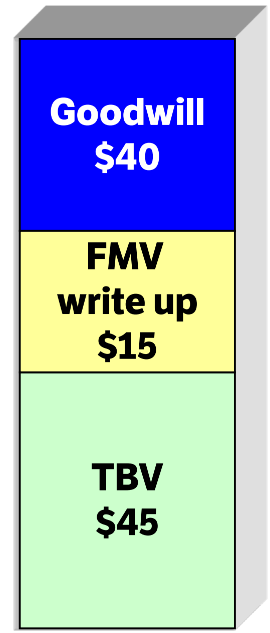
- Acquirers often pay more than the FMV of target's individual assets, net of liabilities
- Reasons include synergies and the notion that the value of a business can be greater than simply the sum of the individual assets when organized in a certain way
- Of course, overpayment is another reason

Purchase price allocation (PPA)

- Purchase price allocation is the process of getting from a pre-deal target BS to a post-deal target BS
  - Allocate the purchase price to target's tangible book value (TBV), defined as assets, excluding goodwill, less liabilities
  - Write-up equity to FMV
  - If purchase price is > FMV, the excess is allocated to goodwill

Illustration: Purchase price allocation

Revising a target's BS to reflect a $100 purchase price, when the TBV is $45 and the FMV of the equity is $15 greater than the book value.



Writing up equity to FMV

- Since many assets are commonly carried at below FMV on target BS (PP&E, intangibles, LIFO inventory), they require write-up upon an acquisition
- Estimating write-ups in models: Actual appraisals are conducted at late stages of the deal and often long after initial analysis is required, so practitioners often estimate the write-ups by applying an "industry" % or simply ignoring write-ups entirely

PPA exercise I

Adjusting the target balance sheet in accordance with PPA

Purchase price of target:	1,000.0				
FMV of target PP&E	400.0				
Target balance sheet		Step 1	Step 2	Step 3	
	Pre-deal Target BS	Elimination of existing GW	Adjust to FMV	Calculate new GW	New Target BS
Cash	100.0				
PP&E	300.0				
Goodwill	50.0				
Total assets	450.0				
Deferred tax liabilities	0.0				
Debt	50.0				
Equity	400.0				
Total liabilities & equity	450.0				

PPA exercise I solution

Adjusting the target balance sheet in accordance with PPA

Purchase price of target:	1,000.0				
FMV of target PP&E	400.0				
Target balance sheet		Step 1	Step 2	Step 3	
	Pre-deal Target BS	Elimination of existing GW	Adjust to FMV	Calculate new GW	New Target BS
Cash	100.0				100.0
PP&E	300.0		100.0		400.0
Goodwill	50.0	(50.0)		550.0	550.0
Total assets	450.0				1,050.0
Deferred tax liabilities	0.0				0.0
Debt	50.0				50.0
Equity	400.0	(50.0)	100.0	550.0	1,000.0
Total liabilities & equity	450.0				1,050.0

Book versus tax differences in M&A

- Up until now, we have been discussing the effect on the GAAP balance sheet.
- Since companies prepare 2 sets of books – 1 in accordance with GAAP (book) and the other with tax rules, we need to address issues that emerge when there are differences.

Book versus tax differences in M&A

- Depending on how a deal is structured, there can be a major difference between the carrying values of assets for book vs. tax purposes
- Here is the “book versus tax” paradigm in M&A

	BOOK (GAAP)	TAX	
TRANSACTION STRUCTURE	All types	Stock Sale	Asset Sale or 338(h)(10) election
CHANGE IN BASIS? *The carrying values of assets and liabilities*	**YES** Book basis gets written up (or down) to FMV	**NO** Tax basis of assets does not get stepped up (or down) to FMV	**YES** Tax basis does get stepped up (or down) to FMV

Deferred taxes in M&A

- In this section, we will discuss the accounting and real implications of these differences. Keep in mind:

  1. While the GAAP basis is disclosed, the tax basis will likely be unknown to you.
  2. As a result, assumptions must be made and the framework introduced here provides for “rules of thumb” in the typical context of limited information.
  3. A complete assessment of tax issues should always be conducted in consultation with qualified tax advisors.

Deferred taxes in M&A

- When deals are structured as asset sales/338(h)(10): Target's book and tax balance sheets both get marked up to fair value, with excess getting recorded as goodwill.
  - The now-higher-valued assets lead to higher future D&A, reducing taxable income, creating future tax savings for the acquirer.
  - Additionally, unlike book accounting, tax accounting allows goodwill to be amortized[1], often adding significant future tax savings for acquirers in asset sales.

[1] In an asset sale, goodwill is tax deductible and amortized over 15 years, along with other intangible assets that fall under IRC section 197. Goodwill is not deductible in stock sales.

Deferred taxes in M&A

- When deals are structured as stock sales: Target's book BS gets marked up, but the tax BS doesn't; this is mostly temporary since the assets getting written up will be depreciated over time.

- GAAP accounts for the temporary difference between the book and tax basis of assets and liabilities via the creation, on deal day, of deferred tax assets and liabilities (DTAs and DTLs).

  - Two major exceptions to this are land and goodwill, which don't get depreciated or amortized, creating permanent differences and as a result no deferred taxes.

Exercise: Deferred taxes in M&A

- Revisiting our prior exercise, let's make a couple of other assumptions and fill in the blanks:

Tax basis of PP&E:	\$300[1]
FMV of PP&E:	\$400
Nature of PP&E:	Fully depreciable (i.e. no land, no savage value)
Depreciation method:	Straight-line[2]
Useful life:	2 years
Tax rate:	40%

	Book P&L post-deal		Tax P&L post-deal	
	Year 1	Year 2	Year 1	Year 2
Revenues (all cash):	500	500	500	500
Cash expenses	0	0	0	0
Depreciation				
Pre-tax profit				
Tax				
Net income				

[1] Since the actual tax basis is usually unknown unless provided by the target, a common assumption is that the pre-deal book basis equals the tax basis.

[2] We assumed straight-line for simplicity. In actuality, IRC and most tax codes outside the US call for an accelerated depreciation method (MACRS in the U.S).

Exercise: Deferred taxes in M&A

Tax basis of PP&E:	$300
FMV of PP&E:	$400
Nature of PP&E:	Fully depreciable (i.e. no land, no savage value)
Depreciation method:	Straight-line
Useful life:	2 years
Tax rate:	40%

	Book P&L post-deal		**Tax P&L post-deal**	
	Year 1	Year 2	Year 1	Year 2
Revenues (all cash):	500	500	500	500
Cash expenses	0	0	0	0
Depreciation	200	200	150	150
Pre-tax profit	300	300	350	350
Tax	120	120	140	140
Net income	180	180	210	210

- To account for the higher future actual taxes (vs. GAAP taxes), a DTL is recognized on the acquisition date in the amount of the total future differences…

Exercise: Deferred taxes in M&A

- Identify the affect of the PP&E write-up on deal-day, and the changes to the GAAP balance sheet in years 1 and 2

Select balance sheet items

	On acquisition date	1 year post-deal	2 years post-deal
Cash			
PP&E	+100.0		
Deferred tax liability			
Equity			
Total liabilities & equity			
Do assets = liabilities & equity?			

Exercise: Deferred taxes in M&A

- As the PP&E depreciates, the DTL is reversed, until both book and tax bases converge to 0, at which point the DTL fully reverses itself

Select balance sheet items	On acquisition date	1 year post-deal	2 years post-deal
Cash		+360.0	+360.0
PP&E	+100.0	(200.0)	(200.0)
Deferred tax liability	+40.0	(20.0)	(20.0)
Equity	+60.0	+180.0	+180.0
Total liabilities & equity	+100.0	+160.0	+160.0
Do assets = liabilities & equity?	Yes	Yes	Yes

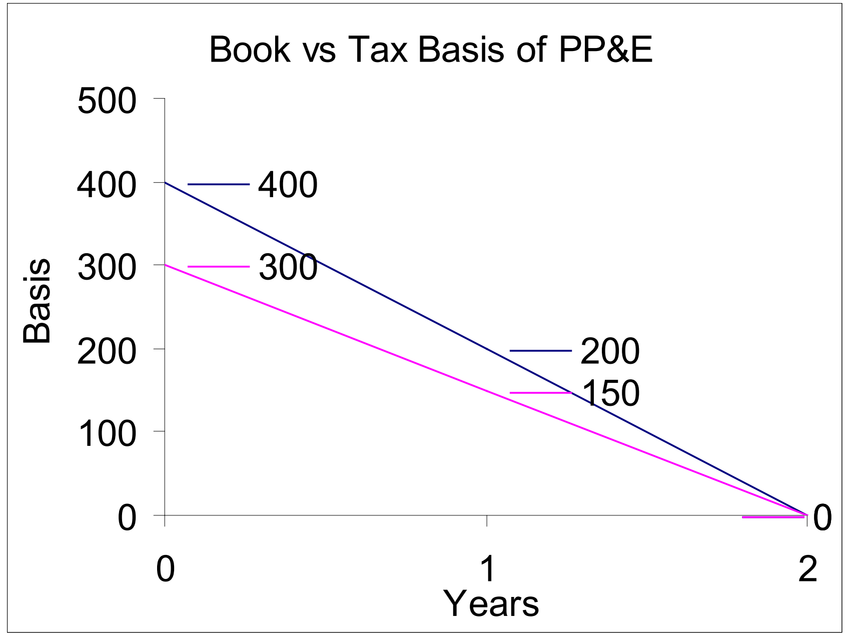
Deferred taxes in M&A

- You may have noticed that this initial DTL is simply the tax rate times the write-up
- This is no coincidence. In fact, we can now formulate a general rule for calculating deferred taxes in a stock sale:
- DTL created in M&A stock sale = (FV book basis – tax basis) x tax rate

Remember that in an asset sale or 338(h)(10) election, no DTL is created because the book and tax bases both get an increase in basis

Deferred taxes in M&A

- We can calculate the DTL for each period:
- DTL0 = \$100 x 40% = \$40
- DTL1 = \$50 x 40% = \$20
- DTL2 = \$0 x 40% = \$0



- Note how the difference that was created on deal day is indeed temporary ending when the bases converge.

Revisiting PPA exercise I for deal structured as a stock sale (no tax step-up)

Adjusting the target balance sheet in accordance with PPA

Purchase price of target:	1,000.0				
FMV of target PP&E	400.0				
Target balance sheet		Step 1	Step 2	Step 3	
	Pre-deal Target BS	Elimination of existing GW	Adjust to FMV	Calculate new GW	New Target BS
Cash	100.0				
PP&E	300.0				
Goodwill	50.0				
Total assets	450.0				
Deferred tax liabilities	0.0				
Debt	50.0				
Equity	400.0				
Total liabilities & equity	450.0				

Revisiting PPA exercise I

Adjusting the target balance sheet in accordance with PPA

Purchase price of target:	1,000.0				
FMV of target PP&E	400.0				
Target balance sheet		Step 1	Step 2	Step 3	
	Pre-deal Target BS	Elimination of existing GW	Adjust to FMV	Calculate new GW	New Target BS
Cash	100.0				100.0
PP&E	300.0		100.0		400.0
Goodwill	50.0	(50.0)		590.0	590.0
Total assets	450.0				1,090.0
Deferred tax liabilities	0.0		40.0		40.0
Debt	50.0				50.0
Equity	400.0	(50.0)	60.0	590.0	1,000.0
Total liabilities & equity	450.0				1,090.0

Observe that the creation of the DTL led to a lower FMV of equity, which in turn led to higher goodwill than had a DTL not been recorded.

Target pre-deal DTLs

- An interesting question arises with the respect to the treatment of pre-deal DTAs and DTLs on the target's BS.
- Pre-existing DTLs (asset sales/338(h)(10)): Book and tax bases are both revalued to FMV so existing DTLs are eliminated (with a corresponding increase in equity).
- Pre-existing DTLs (stock sales): Existing DTLs are retained because there is no tax basis step-up so differences persist (and magnified via the new write-ups).

Target pre-deal DTAs in asset sales/338(h)(10)

- The treatment of existing DTAs depends on the nature of the DTAs. An often substantial DTA represents future potential benefits from historical losses (NOLs) that can be applied against future income.
- DTAs from NOLs: Acquirer cannot benefit from target NOLs so DTAs from NOLs are eliminated.[1]
- Other DTAs: DTAs from other issues (like revenue recognition) carry over.

[1] Although the acquirer can't use the NOLs, the target can use its own NOLs to offset the target's gain on sale

Target pre-deal NOLs in stock sales

- When a company acquires a target with large NOLs, the IRS places an annual limit on the amount of NOLs that can be carried forward, calculated as:
  - Annual limit = Purchase price x % LT tax exempt rate
- The LT tax exempt rate is published monthly by the IRS[1]
- The practical consequence of this is that when NOLs are significant, DTAs must get written down substantially on deal-day.

Adjusted Long Term Rates	
September 2014 Rev.Rul. 2014-22	2.94%
August 2014 Rev.Rul. 2014-19	3.05%
July 2014 Rev.Rul. 2014-20	3.06%
June 2014 Rev.Rul. 2014-16	3.14%

[1] LT tax exempt rate http://pmstax.com/afr/exemptAFR.shtml

Summary

Deal structure	Stock Sale	Asset Sale or 338(h)(10)
Change in book basis?	YES	YES
Change in tax basis?	NO	YES
Goodwill tax deductible?	NO	YES
New DTL created?	YES[1]	NO
Existing DTLs eliminated?	NO	YES
Existing NOLs usable by acquirer?	YES but limited under IRC 382	NO[2]
Non-NOL related DTAs carry over to acquirer?	YES	YES

Remember! These guidelines make several critical assumptions about tax bases and the nature of DTAs and DTLs – consult with tax professional when appropriate

[1] Calculated as (FV book basis – tax basis) x tax rate. DTL reverses over time; goodwill higher due to new DTL
[2] Although acquirer can't use NOLs, the target can use to offset gain on sale

Mergers & Acquisitions Modeling

Key Considerations in M&A

4

Key target considerations in M&A

- Offer price
- Tax structure
- Restrictions on newly-issued stock (in stock sale or mix)
- Post-transaction management and board composition & compensation (in stock sale or mix)
- Earn-outs, when applicable
- Floating vs. fixed exchange deal structure (TBD)

Key acquirer considerations in M&A

- Same as target considerations
- Accounting issues from write-up of target assets
- Strategic acquirers also care a lot about accretion/dilution to cash EPS and GAAP EPS

Modeling a Deal: Apple Buys Disney

Our case study

- An Apple-Disney union has been the subject of Wall Street speculation for years

The Washington Post

Innovations

Apple buying Disney? A consultant explains why he thinks a deal is 'frighteningly obvious.'

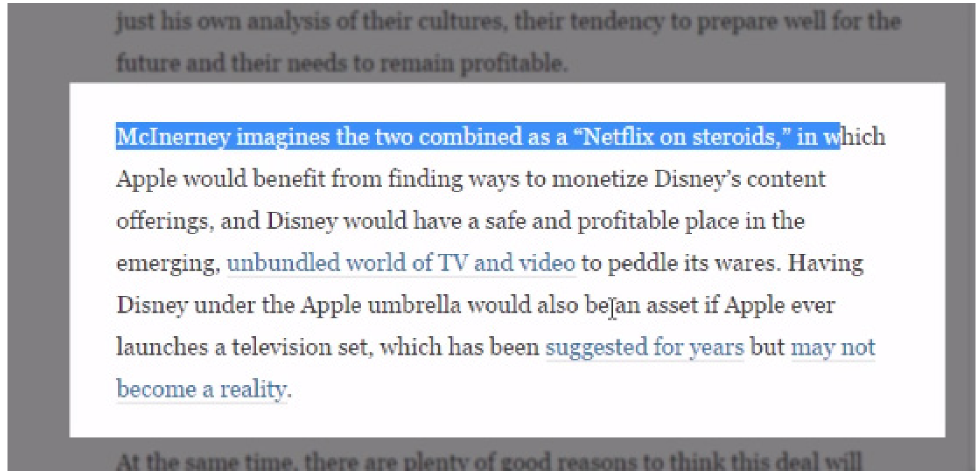
By Matt McFarland June 25 Follow @mattmcfarland

Francis McInerney is convinced Apple will buy Disney. (Andrew Burton/Getty Images)

Apple's success has started to become a problem. The company's revenue and profits have grown so fast that it's difficult for it to find new markets that will be large enough to ensure its revenues continue growing.

Our case study

- It is Tuesday morning, September 9, 2014
- Your senior banker has gotten Apple to agree to a meeting about his Disney pitch


just his own analysis of their cultures, their tendency to prepare well for the future and their needs to remain profitable.

McInerney imagines the two combined as a "Netflix on steroids," in which Apple would benefit from finding ways to monetize Disney's content offerings, and Disney would have a safe and profitable place in the emerging, unbundled world of TV and video to peddle its wares. Having Disney under the Apple umbrella would also be an asset if Apple ever launches a television set, which has been suggested for years but may not become a reality.

At the same time, there are plenty of good reasons to think this deal will

- Ahead of the meeting, you are tasked with modeling the deal

Let's Model

The following modeling steps cover:

- General inputs
- Calculating acquirer & target diluted shares
- Key deal & financing assumptions
- Sources & uses of funds

Open the following files to begin:

- Accretion_Dilution_Model_Empty.xlsx
- Apple & Disney 2013 10K
- Apple & Disney Q3 2014 10Q
- AAPL & Disney Consensus IS Factset Quarterly.pdf

Input general transaction assumptions as illustrated

1. Input company tickers and identify the latest 10Q/10K filing dates for both companies (latest as of 9/9/14)
2. Assume a 25% offer premium

3	*In millions, except per share data*	
4		
5	**Transaction Assumptions**	
6		
7	**General information**	
8	Current date	9/8/2014
9		
10	**Acquirer**	
11	Name	Apple
12	Ticker	
13	Latest filing date	
14	Filing type (10K or 10Q)	
15	Current share price	$98.76
16		
17	**Target**	
18	Name	Disney
19	Ticker	
20	Latest filing date	
21	Filing type (10K or 10Q)	
22	Current share price	$90.40
23	*% Offer premium*	25%
24	Offer price per share	
25	Diluted shares outstanding (MM)	
26	Offer value	

Make a dropdown (user selects either 10K or 10Q) using data validation

Leave diluted shares out. and offer value blank for now (we'll get to it in the next step)

Check your work

C24 | f_x | =C22*(1+C23)

	A	B	C
1			
2		**M&A Model**	
3		*In millions, except per share data*	
4			
5		**Transaction Assumptions**	
6			
7		**General information**	
8		Current date	9/8/2014
9			
10		**Acquirer**	
11		Name	Apple
12		Ticker	AAPL
13		Latest filing date	6/28/2014
14		Filing type (10K or 10Q)	10-Q
15		Current share price	$98.76
16			
17		**Target**	
18		Name	Disney
19		Ticker	DIS
20		Latest filing date	6/28/2014
21		Filing type (10K or 10Q)	10Q
22		Current share price	$90.40
23		*% Offer premium*	25%
24		Offer price per share	$113.00
25		Diluted shares outstanding (MM)	
26		Offer value	

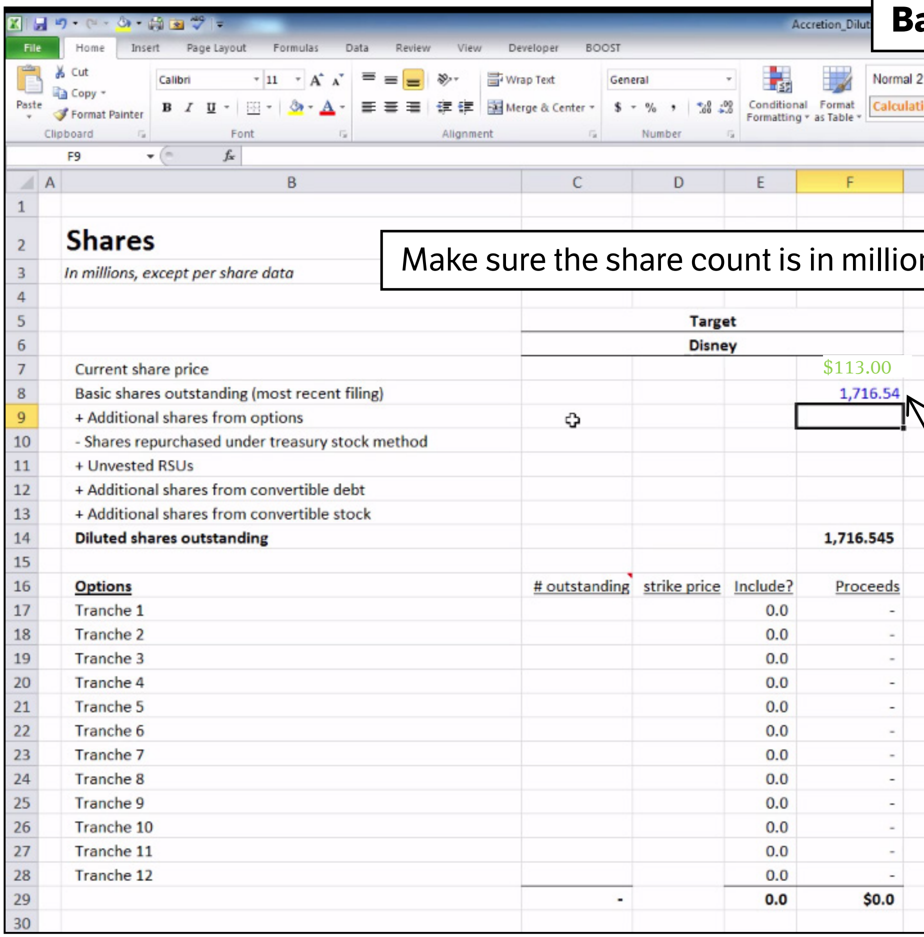
We now turn to finding Disney's shares. We need is to determine offer value…

Calculating diluted shares for Disney

We start by finding Disney's latest actual shares (basic shares)

Basic shares - always front cover of latest 10K/10Q

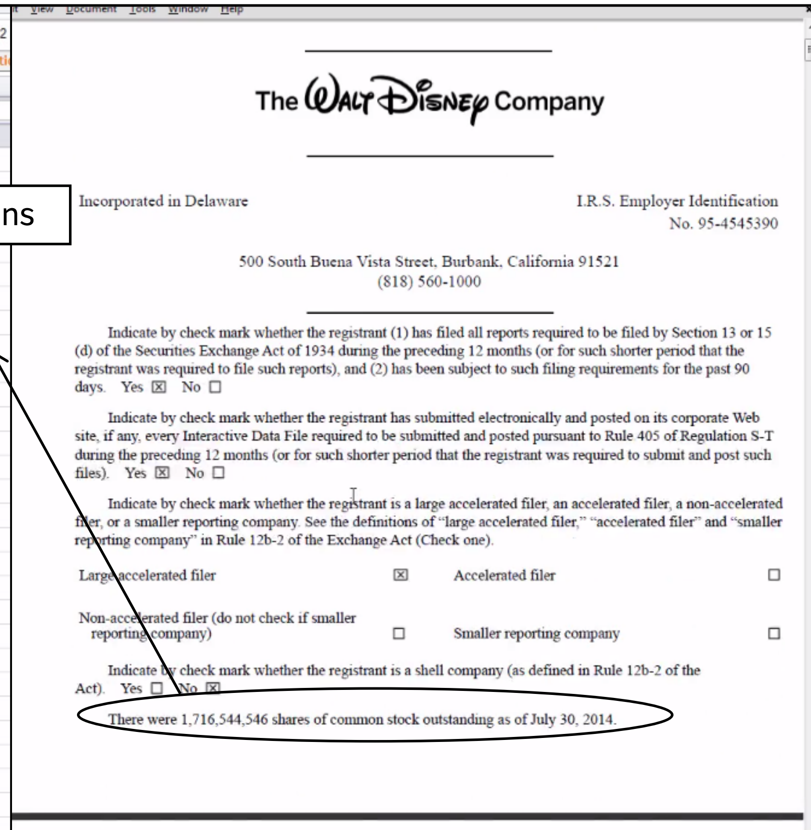
Make sure the share count is in millions



Shares

In millions, except per share data

			Target		
			Disney		
Current share price					$113.00
Basic shares outstanding (most recent filing)					1,716.54
+ Additional shares from options					
- Shares repurchased under treasury stock method					
+ Unvested RSUs					
+ Additional shares from convertible debt					
+ Additional shares from convertible stock					
Diluted shares outstanding					**1,716.545**
Options	# outstanding	strike price	Include?		Proceeds
Tranche 1			0.0		-
Tranche 2			0.0		-
Tranche 3			0.0		-
Tranche 4			0.0		-
Tranche 5			0.0		-
Tranche 6			0.0		-
Tranche 7			0.0		-
Tranche 8			0.0		-
Tranche 9			0.0		-
Tranche 10			0.0		-
Tranche 11			0.0		-
Tranche 12			0.0		-
	-		**0.0**		**$0.0**



The Walt Disney Company

Incorporated in Delaware

I.R.S. Employer Identification No. 95-4545390

500 South Buena Vista Street, Burbank, California 91521
(818) 560-1000

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ☒ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act (Check one).

Large accelerated filer ☒ Accelerated filer ☐

Non-accelerated filer (do not check if smaller reporting company) ☐ Smaller reporting company ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes ☐ No ☒

There were 1,716,544,546 shares of common stock outstanding as of July 30, 2014.

Dilutive securities in M&A/LBO

- Options: Assume options automatically vest: Add outstanding & exercisable options, using the treasury stock method to calculate net dilution
- Restricted stock/RSUs: Assume auto-vest so add all outstanding shares/units (remember no exercise price = no proceeds for restricted stock)

More on unvested options & restricted stock in acquisitions
Note that there is not an automatic vest in all deals, but even in the absence of an automatic vest, most practitioners include the unvested in-the-money options/restricted stock.

The logic for inclusion is that they are expected to vest at some point and should thus be factored in as a real claim on the equity.

Contradiction?
While a similar argument can be made for including unvested options and restricted stock when calculating diluted shares in trading comps and standalone DCF analyses, practitioners rarely include unvested options in the diluted share count in those cases (for better or worse).

Some argue for including the unvested options and restricted stock but applying an illiquidity discount and while this is logical, it is rarely in practice.

Dilutive securities
For a full review of how to treat dilutive securities including RSUs, restricted stock, warrants and convertible securities, please see **WSP's Trading Comps Online Lessons 12-18**

Finding DIS options
Input options data using disclosures in the 10K pp. 98-99 (pp. 101-102 in pdf) .
Since unvested options often auto-vest in acquisitions, include both vested and unvested tranches.

12 ***Equity-Based Compensation***

The following tables summarize information about stock options vested and expected to vest at September 28, 2013 (shares in millions):

	Vested		
Range of Exercise Prices	Number of Options	Weighted Average Exercise Price	Weighted Average Remaining Years of Contractual Life
\$ 0 — \$ 20	1	\$ 18.90	1.8
\$ 21 — \$ 25	3	21.70	1.9
\$ 26 — \$ 30	6	28.84	1.7
\$ 31 — \$ 35	5	32.38	3.6
\$ 36 — \$ 45	3	39.60	7.7
	18		

	Expected to Vest		
Range of Exercise Prices	Number of Options (1)	Weighted Average Exercise Price	Weighted Average Remaining Years of Contractual Life
\$ 0 — \$ 30	1	\$ 27.84	2.5
\$ 31 — \$ 35	2	31.19	6.3
\$ 36 — \$ 45	10	39.11	7.9
\$ 46 — \$ 65	7	51.17	9.3
	20		

(1) Number of options expected to vest is total unvested options less estimated forfeitures.

Finding dilutive securities disclosures
Even when there is a more recent 10Q, 10Ks end up being the primary document for finding dilutive securities data because 10Qs have limited disclosures.

That said, you still want to first check the 10Q to make sure there aren't complete disclosures.

Stock options Disney gives us a tranche-by-tranche breakout of both vested and unvested options. Because we assume auto vest in a deal with Apple, we include both.

Input DIS options data into the shares tab

Shares

In millions, except per share data

	# outstanding	strike price	Include?	Proceeds
	Target			
	Disney			
Current share price				$113.00
Basic shares outstanding (most recent filing)				1,716.54
+ Additional shares from options				38.0
- Shares repurchased under treasury stock method				(12.2)
+ Unvested RSUs				
+ Additional shares from convertible debt				
+ Additional shares from convertible stock				
Diluted shares outstanding				**1,742.356**
Options	# outstanding	strike price	Include?	Proceeds
Tranche 1	1	18.90	1.0	18.9
Tranche 2	3	21.70	3.0	65.1
Tranche 3	6	28.84	6.0	173.0
Tranche 4	5	32.38	5.0	161.9
Tranche 5	3	39.6	3.0	118.8
Tranche 6	1	27.84	1.0	27.8
Tranche 7	2	31.19	2.0	62.4
Tranche 8	10	39.11	10.0	391.1
Tranche 9	7	51.17	7.0	358.2
Tranche 10			0.0	-
Tranche 11			0.0	-
Tranche 12			0.0	-
	38.000		**38.0**	**$1,377.3**

Note: The excel file that corresponds to this exercise will show a slightly different

Since the exercise (strike) price is lower than the offer price, all options are in-the-money. The treasury stock method assumes that all option proceeds are used to repurchase shares (at the assumed offer price) to mitigate dilution.

Finding DIS restricted shares
Disclosure directly below stock options data in the 10K

The following table summarizes information about RSU transactions (shares in millions):

	2013		
	Units		Weighted Average Grant-Date Fair Value
Unvested at beginning of year	27	$	35.49
Granted [1]	7		50.92
Vested	(12)		31.73
Forfeited	(1)		36.65
Unvested at end of year [2]	21		42.28

[1] RSU grants include 0.4 million shares of Performance RSUs.

[2] 1.3 million of the unvested RSUs are Performance RSUs.

Complete the diluted shares calculation

- Input DIS restricted shares
- Check to see if DIS has any convertible securities. If so, are they dilutive?

Shares

In millions, except per share data

				Target
				Disney
Current share price				$113.00
Basic shares outstanding (most recent filing)				1,716.54
+ Additional shares from options				38.0
- Shares repurchased under treasury stock method				(12.2)
+ Unvested RSUs				21.0
+ Additional shares from convertible debt				
+ Additional shares from convertible stock				
Diluted shares outstanding				**1,763.356**

Options	# outstanding	strike price	Include?	Proceeds
Tranche 1	1	18.90	1.0	18.9
Tranche 2	3	21.70	3.0	65.1
Tranche 3	6	28.84	6.0	173.0
Tranche 4	5	32.38	5.0	161.9
Tranche 5	3	39.6	3.0	118.8
Tranche 6	1	27.84	1.0	27.8
Tranche 7	2	31.19	2.0	62.4
Tranche 8	10	39.11	10.0	391.1
Tranche 9	7	51.17	7.0	358.2
Tranche 10			0.0	-
Tranche 11			0.0	-
Tranche 12			0.0	-
	38.000		**38.0**	**$1,377.3**

Similar to options, we include all unvested RSUs in the diluted share count under the assumption RSUs would auto-vest in a deal with Apple.

Go back to the model tab to calculate offer value

- Reference the diluted shares from the shares tab
- Calculate offer value

7	**General information**	
8	Current date	9/8/2014
9		
10	**Acquirer**	
11	Name	Apple
12	Ticker	AAPL
13	Latest filing date	6/28/2014
14	Filing type (10K or 10Q)	10-Q
15	Current share price	$98.76
16		
17	**Target**	
18	Name	Disney
19	Ticker	DIS
20	Latest filing date	6/28/2014
21	Filing type (10K or 10Q)	10Q
22	Current share price	$90.40
23	*% Offer premium*	25%
24	Offer price per share	$113.00
25	Diluted shares outstanding (MM)	1,763.4
26	Offer value	199,259.3

Before proceeding, let's also calculate Apple diluted shares. Remember:

- Latest actual share count is on cover of latest 10K/10Q
- You usually have to go to the 10K to get options disclosures. In Apple's case, the latest 10Q (p. 20 of the pdf) provided the same level of detail as the staler 10K, so you want to use the fresher 10Q data in this case.
- Check for any convertible securities

RSUs: Unlike the target RSUs, unvested acquirer RSUs are not going to be included in the diluted share count for the acquiring company in a deal – those don't auto vest like the target's.

	(in thousands)	Value	(in millions)
Balance at September 28, 2013	93,284	$ 62.24	
RSUs granted	53,730	$ 72.18	
RSUs vested	(35,529)	$ 58.87	
RSUs cancelled	(4,401)	$ 67.64	
Balance at June 28, 2014	107,084	$ 68.12	$ 9,850

RSUs that vested during the three- and nine-month periods ended June 28, 2014 had fair values of $1.3 billion and $2.6 billion, respectively, as of the vesting date. RSUs that vested during the three- and nine-month periods ended June 29, 2013 had fair values of $1.2 billion and $2.9 billion, respectively, as of the vesting date.

Stock Options

The Company had 13.1 million stock options outstanding as of June 28, 2014, with a weighted average exercise price per share of $22.39 and weighted average remaining contractual term of 1.1 years, substantially all of which are exercisable. The aggregate intrinsic value of the stock options outstanding as of June 28, 2014 was $908 million, which represents the value of the Company's closing stock price on the last trading day of the period in excess of the weighted-average exercise price multiplied by the number of options outstanding.

Apple June 2014 stock split

Between the filing of the 2013 10K and latest 2014 10Q, Apple underwent a 7-for-1 stock split. It's not an issue for us because we used the fresh 10Q data but if for example, Apple hadn't provided options data in their 10Q, we would need to adjust the 10K exercise price (divide by 7) and the number of exercisable options (multiply by 7).

Apple's options disclosure in their 2013 10K is pre 7-for-1 stock split

	Number of Options (in thousands)	Weighted-Average Exercise Price
Balance at September 25, 2010	21,725	$ 90.46
Options granted	1	$342.62
Options cancelled	(163)	$128.42
Options exercised	(9,697)	$ 67.63
Balance at September 24, 2011	11,866	$108.64
Options assumed	41	$ 30.86
Options cancelled	(25)	$103.22
Options exercised	(5,337)	$ 84.85
Balance at September 29, 2012	6,545	$127.56
Options granted	8	$ 30.36
Options assumed	29	$210.08
Options cancelled	(8)	$108.87
Options exercised	(2,480)	$108.33
Balance at September 28, 2013	4,094	$139.65
Exercisable at September 28, 2013	4,072	$140.07
Expected to vest after September 28, 2013	22	$ 61.93

Complete the AAPL diluted shares table

H17 f_x 13.1

	B	C	D	E	F	G	H	I	J	K
1										
2	**Shares**									
3	*In millions, except per share data*									
4										
5			**Target**					**Acquirer**		
6			**Disney**					**Apple**		
7	Current share price				$113.00					$98.76
8	Shares outstanding (most recent filing)				1,717					5,987.867
9	+ Additional shares from options				38.000					13.100
10	- Shares repurchased under treasury stock method				(12.188)					(2.970)
11	+ Unvested RSUs				21.000					0.000
12	+ Additional shares from convertible debt				0.000					0.000
13	+ Additional shares from convertible stock				0.000					0.000
14	**Total Shares Outstanding**				**1,763.356**					**5,997.997**
15										
16	**Options**	# outstanding	strike price	Include?	Proceeds		# exercisable	strike price	Include?	Proceeds
17	Tranche 1	1.000	$18.90	1.0	18.9		13.100	22.390	13.1	293.3
18	Tranche 2	3.000	21.70	3.0	65.1				0.0	-
19	Tranche 3	6.000	28.84	6.0	173.0				0.0	-
20	Tranche 4	5.000	32.38	5.0	161.9				0.0	-
21	Tranche 5	3.000	39.60	3.0	118.8				0.0	-
22	Tranche 6	1.000	27.84	1.0	27.8				0.0	-
23	Tranche 7	2.000	31.19	2.0	62.4				0.0	-
24	Tranche 8	10.000	39.11	10.0	391.1				0.0	-

Reference from model tab

Front cover of latest 10Q

From 10Q

Input deal structure and other assumptions

F36

	B	C
22	Current share price	$90.40
23	*% Offer premium*	25%
24	Offer price per share	$113.00
25	Diluted shares outstanding (MM)	1,763.4
26	Offer value	199,259.3
27		
28	**Deal structure**	
29	% Stock	60%
30	% Cash	40%
31	Tax structure	
32	Acquirer shares issued in transaction	
33	*Nominal exchange ratio (offer price/acq share price)*	
34	*Actual exchange ratio (% stock x offer price/acq share price)*	
35		
36	**Other assumptions**	
37	Deal fees as % of offer value	0.50%
38	Deal fees	996.3
39	Assumed annual pretax cost synergies	100.0
40	Apple calendar year ending 2014 EBITDA	
41	Disney calendar year ending 2014 EBITDA	
42	Acquirer tax rate	
43	Target tax rate	

Stock/cash: Assume 60% of offer value funded with stock; remainder with cash

Tax structure: Create a dropdown with 2 options: 'Asset Sale/338' or 'Stock Sale.' In line with most public deals assume Stock Sale

Acquirer shares issued & exchange ratios: Determine # of new AAPL shares, nominal & exchange ratios

Deal fees: Fees range from 0.5% - 3% of offer value. We assume 0.5% here due to the large deal size

Synergies: Will be unknown until later stages of due diligence. Assume $100m as a placeholder.

Calculate 2014E **calendar year** EBITDA using the Factset estimates we provided in your files. You'll need to add 4 quarters of EBITDA.

Tax rates: Locate AAPL & DIS disclosure for last 9 months' effective tax rate in their latest 10Qs – assume these rates going forward

Check your work

	A	B	C	D	
22		Current share price	$90.40		*Do sources equal uses?*
23		*% Offer premium*	25%		
24		Offer price per share	$113.00		**Write-Ups and Purchase I**
25		Diluted shares outstanding (MM)	1,763.4		
26		Offer value	199,259.3		**Asset write-ups**
27					Tangible assets
28		**Deal structure**			Book value of target PP&
29		% Stock	60%		% Write-up
30		% Cash	40%		Asset write-up
31		Tax structure	Stock sale		Useful life
32		Acquirer shares issued in transaction	1,211		Incremental depreciatic
33		*Nominal exchange ratio (offer price/acq share price)*	1.144x		Incremental deferred ta
34		*Actual exchange ratio (% stock x offer price/acq share price)*	0.687x		
35					
36		**Other assumptions**			
37		Deal fees as % of offer value	0.50%		
38		Deal fees	996.3		
39		Assumed annual pretax cost synergies	100.0		
40		Apple calendar year ending 2014 EBITDA	61,615		
41		Disney calendar year ending 2014 EBITDA	14,307		
42		Acquirer tax rate	26.10%		
43		Target tax rate	34.80%		
44					
45		**Transaction financing**			

Wall Street Prep:
WSP estimate

Wall Street Prep:
FS estimates

Wall Street Prep:
FS estimates

Wall Street Prep:
AAPL 2014 Q3 10-Q

Wall Street Prep:
DIS Q3 2014 10-Q

Complete the Transaction Financing section using the assumptions below

	A	B	C
43		Target tax rate	34.80%
44			
45		**Transaction financing**	
46		% Cash consideration financed with debt	80%
47		% Cash consideration financed with excess cash	
48		Acquirer new borrowing	
49		Acquirer excess cash used	
50		*% of total acquirer cash balance*	
51			
52		Treatment of target debt	Refinanced
53		Debt to be refinanced	
54		Total acquisition financing	
55			
56		Acquirer available cash	
57		Target debt outstanding	
58			
59		Term of loan	5 years
60		Financing fees as % of acquisition financing	0.50%
61		Financing fees	
62		Annual financing fee amortization	
63			
64		Interest rate on new debt	4.0%
65		Interest earned on cash	1.0%
66			

Cash consideration is funded by either excess acquirer cash or new borrowing. While Apple has ample cash, let's assume 80% of cash consideration funded via debt

Target Debt in a deal is usually refinanced but sometimes assumed – assume refinanced in this case

Hint: Insert an IF statement

Input Apple's cash from latest 10Q – include short-term and long-term marketable securities

Input Disney's debt and equivalents from latest 10Q

Financing fees: Fees range from 0.5% - 2% of total financing.

Unlike deal fees (which are fully expensed as incurred), financing fees are amortized over term of loan

WSP assumptions

Check your work

	A	B	C	Formula view
43		Target tax rate	34.80%	
44				
45		**Transaction financing**		
46		% Cash consideration financed with debt	80%	0.8
47		% Cash consideration financed with excess cash	20%	=1-C46
48		Acquirer new borrowing	63,763.0	=C46*C30*C26
49		Acquirer excess cash used	15,940.7	=C47*C30*C26
50		*% of total acquirer cash balance*	*9.7%*	*=C49/C56*
51				
52		Treatment of target debt	Refinanced	Refinanced
53		Debt to be refinanced	16,136.0	=IF(C52="Assumed",0,C57)
54		Total acquisition financing	79,899.0	=C46*C30*C26+C53
55				
56		Acquirer available cash	164,490.0	=12977+24828+126685
57		Target debt outstanding	16,136.0	=3216+12920
58				
59		Term of loan	5 years	5
60		Financing fees as % of acquisition financing	0.50%	0.005
61		Financing fees	399.5	=C60*C54
62		Annual financing fee amortization	79.9	=C61/C59
63				
64		Interest rate on new debt	4.0%	0.04
65		Interest earned on cash	1.0%	0.01
66				

Build the Sources & Uses of funds schedule

- The primary **uses of funds** are 1) giving cash to DIS shareholders, 2) giving AAPL stock to DIS shareholders, 3) Refinancing DIS debt and 4) fees
- The primary **sources of funds** are 1) AAPL shares, 2) New borrowing, 3) Excess AAPL cash

	A	B	C	D	E	F
2		**M&A Model**				
3		*In millions, except per share data*				
4						
5		**Transaction Assumptions**			**Sources & Uses of Funds**	
6						
7		**General information**			*Sources of Funds*	
8		Current date	9/8/2014		New borrowing to acquire target	
9					New borrowing to refinance target debt	
10		**Acquirer**			Cash used to acquire target	
11		Name	pple		Value of stock issued to acquire target	
12		Ticker	AAPL		Cash for fees	
13		Latest filing date	/2014		**Total sources**	
14		Filing type (10K or 10Q)	10-Q			
15		Current share price	98.76		*Uses of Funds*	
16					Stock to target	
17		**Target**			Cash to target	
18		Name	isney		Target debt refinanced	
19		Ticker	DIS		Deal fees (advisory, legal, and accounting)	
20		Latest filing date	/2014		Financing fees (related to acq debt)	
21		Filing type (10K or 10Q)	10Q		**Total Uses**	
22		Current share price	$90.40		*Do sources equal uses?*	

Assume AAPL cash will be used to pay fees (beyond the excess cash calculated in the transaction financing section)

# of AAPL shares issued x value of AAPL stock

% cash x offer value

Sources must equal uses

Check your work

Sources & Uses of Funds		Formula view
Sources of Funds		
New borrowing to acquire target	63,763.0	=C48
New borrowing to refinance target debt	16,136.0	=C53
Cash used to acquire target	15,940.7	=C49
Value of stock issued to acquire target	119,555.6	=C29*C26
Cash for fees	1,395.8	=C61+C38
Total sources	216,791.1	=SUM(F8:F12)
Uses of Funds		
Stock to target	119,555.6	=C32*C15
Cash to target	79,703.7	=C30*C26
Target debt refinanced	16,136.0	=C53
Deal fees (advisory, legal, and accounting)	996.3	=C38
Financing fees (related to acq debt)	399.5	=C61
Total Uses	216,791.1	=SUM(F16:F20)
Do sources equal uses?	Yes	=IF(F13=F21,"Yes","No")

Let's Model

The following modeling steps cover:

- Inputting acquirer & target balance sheet historicals
- Building a pro forma balance sheet
- Credit statistics

Continue using the following files:

- Accretion_Dilution_Model_Empty.xlsx
- Apple & Disney 2013 10K

Pro forma balance sheet (B/S) adjustments

- Now that the transaction terms and financing have been established, we can begin to analyze the impact of the deal on AAPL's financial statements:

Pre-deal B/S + Pre-deal B/S + deal & financing adjustments = Pro forma B/S

- AAPL's new pro forma B/S is the sum of AAPL & DIS pre-deal B/S after adjusting for:
  - Deal-related goodwill, asset write-ups, etc.
  - New debt and equity from deal financing

Input B/S historicals for AAPL & DIS

- Take the latest balance sheets of both companies and lay them side by side
- Since line items are often classified differently across different companies, you'll often need to aggregate certain line items

G	H	I	J	K	L	M
4						
5	**Pro Forma Balance Sheet**					
6		**Standalone**		Adjustments		**Pro Forma**
7		Acquirer	Target			
8						
9				Increase	(Decrease)	
10	Cash and equivalents					
11	Accounts receivable					
12	Inventory					
13	Deferred tax assets (current and long term)					
14	Other current assets					
15	PP&E					
16	Intangible assets					
17	Goodwill					
18	Other assets					
19	**Total assets**					
20	Accounts payable					
21	Accrued expenses & def rev. (current & non-current)					
22	Revolver and current debt					
23	Long term debt					
24	Convertible debt					
25	Deferred tax liabilities					
26	Other liabilities					
27	Preferred stock					
28	Noncontrolling interests					
29	Shareholders' equity					
30	**Total liabilities + shareholder equity**					
31	*Balance check*					

AAPL notes

1. Cash and equivalents: Reference from cell C56
2. Other current assets: Include vendor non-trade receivables
3. Revolver & current debt: Include commercial paper
4. Equity: Combine all equity line items into 1 line

DIS notes

1. Cash and equivalents: Include investments
2. Other current assets: Include TV costs and advances
3. Other assets: Include Film & TV costs
4. Equity: Combine all equity line items into 1 line

Check your work

	G	H	I	J
4				
5		**Pro Forma Balance Sheet**		
6			**Standalone**	
7			Acquirer	Target
8			AAPL	DIS
9			*6/28/14*	*6/28/14*
10		Cash and equivalents	164,490.0	6,948.0
11		Accounts receivable	10,788.0	7,543.0
12		Inventory	1,594.0	1,425.0
13		Deferred tax assets (current and long term)	3,884.0	480.0
14		Other current assets	13,878.0	1,667.0
15		PP&E	17,585.0	23,013.0
16		Intangible assets	3,767.0	7,268.0
17		Goodwill	2,374.0	27,924.0
18		Other assets	4,160.0	7,455.0
19		**Total assets**	**222,520.0**	**83,723.0**
20		Accounts payable	20,535.0	6,379.0
21		Accrued expenses & def rev. (current & non-current)	26,718.0	3,756.0
22		Revolver and current debt	2,010.0	3,216.0
23		Long term debt	29,030.0	12,920.0
24		Convertible debt	0.0	0.0
25		Deferred tax liabilities	0.0	4,360.0
26		Other liabilities	23,287.0	4,480.0
27		Preferred stock	0.0	0.0
28		Noncontrolling interests	0.0	3,092.0
29		Shareholders' equity	120,940.0	45,520.0
30		**Total liabilities + shareholder equity**	**$222,520.0**	**$83,723.0**
31		*Balance check*	*0.0*	*0.0*

Formula view

=C56	=4090+2858
10788	7543
1594	1425
3884	480
=6053+7825	=1095+572
17585	23013
3767	7268
2374	27924
4160	=2430+5025
=SUM(I10:I18)	**=SUM(J10:J18)**
20535	6379
=15264+8396+3058	3756
2010	3216
29030	12920
0	0
0	4360
23287	4480
0	0
0	3092
=22139+98715+86	=34123-39669+52235-1169
=SUM(I20:I29)	**=SUM(J20:J29)**

Pro forma balance sheet (B/S) adjustments

- The excess of the offer value (purchase price) over the book value of Disney equity is either explained by writing up individual assets or – if that isn't justifiable, the rest of the difference creates new goodwill.
- In an acquisition, the line items that tend to get the biggest write-ups (because they are most undervalued due to historical costing) are line items like intangible assets and PP&E.

Pro forma balance sheet (B/S) adjustments

	B	C
1		
2	**M&A Model**	
3	*In millions, except per share data*	
4		
5	**Transaction Assumptions**	
6		
7	**General information**	
8	Current date	9/8/2014
9		
10	**Acquirer**	
11	Name	Apple
12	Ticker	AAPL
13	Latest filing date	6/28/2014
14	Filing type (10K or 10Q)	10-Q
15	Current share price	$98.76
16		
17	**Target**	
18	Name	Disney
19	Ticker	DIS
20	Latest filing date	6/28/2014
21	Filing type (10K or 10Q)	10Q
22	Current share price	$90.40
23	*% Offer premium*	25%
24	Offer price per share	$113.00
25	Diluted shares outstanding (MM)	1,763.4
26	Offer value	199,259.3

	H	I	J
4			
5	**Pro Forma Balance Sheet**		
6		**Standalone**	
7		Acquirer	Target
8		AAPL	DIS
9		*6/28/14*	*6/28/14*
10	Cash and equivalents	164,490.0	6,948.0
11	Accounts receivable	10,788.0	7,543.0
12	Inventory	1,594.0	1,425.0
13	Deferred tax assets (current and long term)	3,884.0	480.0
14	Other current assets	13,878.0	1,667.0
15	PP&E	17,585.0	23,013.0
16	Intangible assets	3,767.0	7,268.0
17	Goodwill	2,374.0	27,924.0
18	Other assets	4,160.0	7,455.0
19	**Total assets**	**222,520.0**	**83,723.0**
20	Accounts payable	20,535.0	6,379.0
21	Accrued expenses & def rev. (current & non-current)	26,718.0	3,756.0
22	Revolver and current debt	2,010.0	3,216.0
23	Long term	29,030.0	12,920.0
24	Convertibl	0.0	0.0
25	Deferred t	0.0	4,360.0
26	Other liabi	23,287.0	4,480.0
27	Preferred stock	0.0	0.0
28	Noncontrolling interests	0.0	3,092.0
29	Shareholders' equity	120,940.0	45,520.0
30	**Total liabilities + shareholder equity**	**$222,520.0**	**$83,723.0**
31	*Balance check*	*0.0*	*0.0*

The new equity value of Disney will be the offer value

Apple will pay $199b to buy the equity of Disney when Disney's book value of equity is only $45b. Why?

- Market value isn't well captured using GAAP, which relies on historical cost.
- In addition, a business is worth more than simply the sum of its parts, even at market value.
- In M&A, all assets/liabs get new cost basis because acquirer now provides a quantifiable new equity price.
- **Purchase price allocation** is process of resetting the value of the target based on that new equity price.

Write-ups – and resulting incremental D&A and deferred taxes

- Make assumptions about which assets get written up and the useful life of those assets[1]
- Calculated the annual incremental D&A from these write ups
- Since we assume the deal is a stock sale, there will be no corresponding step-ups for tax purposes, so calculate the DTL created on day one due to the write-ups. Make sure to insert an IF statement so that no DTLs are created in an asset sale.

I41 | =I40+I38

	B	C	E	F	
22	Current share price	$90.40	*Do sources equal uses?*	Yes	Revolver and current debt
23	*% Offer premium*	25%			Long term debt
24	Offer price per share	$113.00	**Write-Ups and Purchase Price Allocation**		Convertible debt
25	Diluted shares outstanding (MM)	1,763.4			Deferred tax liabilities
26	Offer value	199,259.3	**Asset write-ups**		Other liabilities
27			Tangible assets		**Wall Street Prep:** WSP estimate
28	**Deal structure**		Book value of target PP&E		
29	% Stock	60%	% Write-up	20%	
30	% Cash	40%	Asset write-up		**Wall Street Prep:** WSP estimate
31	Tax structure	Stock sale	Useful life	20 years	*Balance check*
32	Acquirer shares issued in transaction	1,211	Incremental depreciation expense		
33	*Nominal exchange ratio (offer price/acq share price)*	1.144x	Incremental deferred tax liabilities		*Credit statistics*
34	*Actual exchange ratio (% stock x offer price/acq share price)*	0.687x			Total debt
35			Intangible assets		+ Noncontrolling interest
36	**Other assumptions**		Book value of target intangible assets		
37	Deal fees as % of offer value	0.50%	% Write-up	150.0%	**Wall Street Prep:** WSP estimate
38	Deal fees	996.3	Asset write-up		
39	Assumed annual pretax cost synergies	100.0	Useful life	15 years	**Wall Street Prep:** WSP estimate
40	Apple calendar year ending 2014 EBITDA	61,615	Incremental amortization expense		Equity value (share price
41	Disney calendar year ending 2014 EBITDA	14,307	Incremental deferred tax liabilities		Enterprise value

[1] The process of writing up is done by accounting firms which analyze individual assets during a deal and can be as subjective as the process of enterprise level valuation. During a pitch, or even in the midst of a live deal, you will still likely have no real insight into the magnitude of the write-ups. Often these are left at 0, meaning all excess goes to goodwill

Check your work

- Remember that the write-ups will not actually be known until deep into or even after deal announcement so these are sometimes not modeled – meaning all purchase price excess would get modeled as goodwill
- Lets turn to goodwill now…

	B	C	E	F
22	Current share price	$90.40	*Do sources equal uses?*	Yes
23	*% Offer premium*	25%		
24	Offer price per share	$113.00	**Write-Ups and Purchase Price Allocation**	
25	Diluted shares outstanding (MM)	1,763.4		
26	Offer value	199,259.3	**Asset write-ups**	
27			Tangible assets	
28	**Deal structure**		Book value of target PP&E	23,013.0
29	% Stock	60%	% Write-up	20%
30	% Cash	40%	Asset write-up	4,602.6
31	Tax structure	Stock sale	Useful life	20 years
32	Acquirer shares issued in transaction	1,211	Incremental depreciation expense	230.1
33	*Nominal exchange ratio (offer price/acq share price)*	1.144x	Incremental deferred tax liabilities	1,201.3
34	*Actual exchange ratio (% stock x offer price/acq share price)*	0.687x		
35			Intangible assets	
36	**Other assumptions**		Book value of target intangible assets	7,268.0
37	Deal fees as % of offer value	0.50%	% Write-up	150.0%
38	Deal fees	996.3	Asset write-up	10,902
39	Assumed annual pretax cost synergies	100.0	Useful life	15 years
40	Apple calendar year ending 2014 EBITDA	61,615	Incremental amortization expense	726.8
41	Disney calendar year ending 2014 EBITDA	14,307	Incremental deferred tax liabilities	2,845.4

Calculate goodwill

26	199,259.3	**Asset write-ups**	
27		Tangible assets	
28		Book value of target PP&E	23,013.0
29	60%	% Write-up	20%
30	40%	Asset write-up	4,602.6
31	Stock sale	Useful life	20 years
32	1,211	Incremental depreciation expense	230.1
33	1.144x	Incremental deferred tax liabilities	1,201.3
34	0.687x		
35		Intangible assets	
36		Book value of target intangible assets	7,268.0
37	0.50%	% Write-up	150.0%
38	996.3	Asset write-up	10,902
39	100.0	Useful life	15 years
40	61,615	Incremental amortization expense	726.8
41	14,307	Incremental deferred tax liabilities	2,845.4
42	26.10%		
43	34.80%	**Purchase Price Allocation**	
44		*Target assets - book value*	
45		Plus: PP&E write ups	
46	80%	Plus: Intangible asset write ups	
47	20%	Less: Write off of target goodwill	
48	63,763.0	Less: Write off of target deferred tax assets	
49	15,940.7	**Target assets - fair market value**	
50	*9.7%*		
51		*Target liabilities - book value*	
52	Refinanced	Less: Write off of target deferred tax liabilities	
53	16,136.0	Plus: New deferred tax liabilities created	
54	79,899.0	**Target liabilities - fair market value**	
55			
56	164,490.0	Target net book value - fair market value	
57	16,136.0	Offer value	
58		**Goodwill created in transaction**	
59	5 years		

Calculating the FMV of DIS assets

1. Reference total BV of DIS assets from the DIS balance sheet
2. Add intangible and PP&E write-ups
3. Remove prior DIS goodwill
4. Remove DIS DTAs[1]

Calculating the FMV of DIS liabilities

1. Reference BV from the B/S
2. Remove prior DIS DTLs in the case of an asset sale/338[2]
3. Add the DTLs created from the write ups

Goodwill is just the excess of the offer value (purchase price) over the FMV of the assets, less liabilities

[1] In a deal some DTAs carry over and some don't. An often large DTA – DTA due to NOLs – is significantly reduced (or completely eliminated) in an acquisition. In an asset sale/338 they are used to offset the target gain on sale and any residual is eliminated, while in a stock sale, their transfer to acquirer is limited (often severely). We assumed that none carry over, but a true and complete understanding of which DTAs are eliminated and which stay requires a consultation with a qualified tax accounting professional.

[2] Since DTLs often exist to account for differences in book vs. tax bases, in an asset sale (where assets get stepped up basis for both book and tax as opposed to just book in stock sales), the differences that gave rise to the DTLs in the first place are eliminated along with the corresponding DTL.

Check your work

	C	D	E	F	G	Formula view
40	61,615		Incremental amortization expense	726.8		
41	14,307		Incremental deferred tax liabilities	2,845.4		
42	26.10%					
43	34.80%		**Purchase Price Allocation**			
44			*Target assets - book value*	83,723.0		=J19
45			Plus: PP&E write ups	4,602.6		=F30
46	80%		Plus: Intangible asset write ups	10,902		=F38
47	20%		Less: Write off of target goodwill	(27,924.0)		=-(J17)
48	63,763.0		Less: Write off of target deferred tax assets	(480.0)		=-J13
49	15,940.7		**Target assets - fair market value**	70,823.6		=SUM(F44:F48)
50	*9.7%*					
51			*Target liabilities - book value*	38,203.0		=SUM(J20:J28)
52	Refinanced		Less: Write off of target deferred tax liabilities	0.0		=IF(C31="Stock sale",0,-J25)
53	16,136.0		Plus: New deferred tax liabilities created	4,046.7		=F33+F41
54	79,899.0		**Target liabilities - fair market value**	42,249.7		=SUM(F51:F53)
55						
56	164,490.0		Target net book value - fair market value	28,573.9		=F49-F54
57	16,136.0		Offer value	199,259.3		=C26
58			**Goodwill created in transaction**	**170,685.4**		**=F57-F56**
59	5 years					

Setting up the pro forma balance sheet (column M)
Ignoring adjustments for a moment, add formulas in Column M such that each balance sheet line item in column M will combine acquirer's and target's stand-alone balance sheets and capture any adjustments once we make them

	F	G	H	I	J	K	L	M
1								
2								
3								
4								
5			**Pro Forma Balance Sheet**					
6				**Standalone**		Adjustments		**Pro Forma**
7				Acquirer	Target			
8	63,763.0			AAPL	DIS			
9	16,136.0			*6/28/14*	*6/28/14*	Increase	(Decrease)	*6/28/14*
10	15,940.7		Cash and equivalents	164,490.0	6,948.0			
11	119,555.6		Accounts receivable	10,788.0	7,543.0			
12	1,395.8		Inventory	1,594.0	1,425.0			
13	216,791.1		Deferred tax assets (current and long term)	3,884.0	480.0			
14			Other current assets	13,878.0	1,667.0			
15			PP&E	17,585.0	23,013.0			
16	119,555.6		Intangible assets	3,767.0	7,268.0			
17	79,703.7		Goodwill	2,374.0	27,924.0			
18	16,136.0		Other assets	4,160.0	7,455.0			
19	996.3		**Total assets**	**222,520.0**	**83,723.0**			
20	399.5		Accounts payable	20,535.0	6,379.0			
21	216,791.1		Accrued expenses & def rev. (current & non-current)	26,718.0	3,756.0			
22	Yes		Revolver and current debt	2,010.0	3,216.0			
23			Long term debt	29,030.0	12,920.0			
24			Convertible debt	0.0	0.0			
25			Deferred tax liabilities	0.0	4,360.0			
26			Other liabilities	23,287.0	4,480.0			
27			Preferred stock	0.0	0.0			
28	23,013.0		Noncontrolling interests	0.0	3,092.0			
29	20%		Shareholders' equity	120,940.0	45,520.0			
30	4,602.6		**Total liabilities + shareholder equity**	**$222,520.0**	**$83,723.0**			
31	20 years		*Balance check*	*0.0*	*0.0*			

Check your work

Make sure that totals (rows 19 and 30) as well as the balance check (row 31) are calculated directly using data in column M

	F	G	H	I	J	K	L	M
1								
2								
3								
4								
5			**Pro Forma Balance Sheet**					
6				**Standalone**		Adjustments		**Pro Forma**
7				Acquirer	Target			
8	63,763.0			AAPL	DIS			
9	16,136.0			*6/28/14*	*6/28/14*	Increase	(Decrease)	*6/28/14*
10	15,940.7		Cash and equivalents	164,490.0	6,948.0			171,438.0
11	119,555.6		Accounts receivable	10,788.0	7,543.0			18,331.0
12	1,395.8		Inventory	1,594.0	1,425.0			3,019.0
13	216,791.1		Deferred tax assets (current and long term)	3,884.0	480.0			4,364.0
14			Other current assets	13,878.0	1,667.0			15,545.0
15			PP&E	17,585.0	23,013.0			40,598.0
16	119,555.6		Intangible assets	3,767.0	7,268.0			11,035.0
17	79,703.7		Goodwill	2,374.0	27,924.0			30,298.0
18	16,136.0		Other assets	4,160.0	7,455.0			11,615.0
19	996.3		**Total assets**	**222,520.0**	**83,723.0**			**$306,243.0**
20	399.5		Accounts payable	20,535.0	6,379.0			26,914.0
21	216,791.1		Accrued expenses & def rev. (current & non-current)	26,718.0	3,756.0			30,474.0
22	Yes		Revolver and current debt	2,010.0	3,216.0			5,226.0
23			Long term debt	29,030.0	12,920.0			41,950.0
24			Convertible debt	0.0	0.0			0.0
25			Deferred tax liabilities	0.0	4,360.0			4,360.0
26			Other liabilities	23,287.0	4,480.0			27,767.0
27			Preferred stock	0.0	0.0			0.0
28	23,013.0		Noncontrolling interests	0.0	3,092.0			3,092.0
29	20%		Shareholders' equity	120,940.0	45,520.0			166,460.0
30	4,602.6		**Total liabilities + shareholder equity**	**$222,520.0**	**$83,723.0**			**$306,243.0**
31	20 years		*Balance check*	*0.0*	*0.0*			*0.0*

Adjustments: Getting from an Apple stand-alone balance sheet to Apple's pro forma balance sheet
For each line, we need to decide whether we can just lump the Disney's items with Apple's or whether any deal-related adjustments must be made.

	F	G	H	I	J	K	L	M
1								
2								
3								
4								
5			**Pro Forma Balance Sheet**					
6				**Standalone**		Adjustments		**Pro Forma**
7				Acquirer	Target			
8	63,763.0			AAPL	DIS			
9	16,136.0			*6/28/14*	*6/28/14*	Increase	(Decrease)	*6/28/14*
10	15,940.7		Cash and equivalents	164,490.0	6,948.0			171,438.0
11	119,555.6		Accounts receivable	10,788.0	7,543.0			18,331.0
12	1,395.8		Inventory	1,594.0	1,425.0			3,019.0
13	216,791.1		Deferred tax assets (current and long term)	3,884.0	480.0			4,364.0
14			Other current assets	13,878.0	1,667.0			15,545.0
15			PP&E	17,585.0	23,013.0			40,598.0
16	119,555.6		Intangible assets	3,767.0	7,268.0			11,035.0
17	79,703.7		Goodwill	2,374.0	27,924.0			30,298.0
18	16,136.0		Other assets	4,160.0	7,455.0			11,615.0
19	996.3		**Total assets**	**222,520.0**	**83,723.0**			**$306,243.0**
20	399.5		Accounts payable	20,535.0	6,379.0			26,914.0
21	216,791.1		Accrued expenses & def rev. (current & non-current)	26,718.0	3,756.0			30,474.0
22	Yes		Revolver and current debt	2,010.0	3,216.0			5,226.0
23			Long term debt	29,030.0	12,920.0			41,950.0
24			Convertible debt	0.0	0.0			0.0
25			Deferred tax liabilities	0.0	4,360.0			4,360.0
26			Other liabilities	23,287.0	4,480.0			27,767.0
27			Preferred stock	0.0	0.0			0.0
28	23,013.0		Noncontrolling interests	0.0	3,092.0			3,092.0
29	20%		Shareholders' equity	120,940.0	45,520.0			166,460.0
30	4,602.6		**Total liabilities + shareholder equity**	**$222,520.0**	**$83,723.0**			**$306,243.0**
31	20 years		*Balance check*	*0.0*	*0.0*			*0.0*

Cash: Earlier on, we calculated how much cash will be used in the deal. Recall that we assumed cash will be used not only to pay DIS shareholders part of the offer price, but AAPL was also going to use cash to pay financing and deal fees. *Hint: reference from sources & uses of funds table.*

Target DTAs are significantly reduced or totally gone in deals – reference from write-up section.

Pre-deal target goodwill is eliminated – reference from write-up section.

Write-ups and goodwill: Reference write-ups and goodwill from write-up section.

Financing fees: Include capitalized financing fees (link from sources & uses) within intangible assets.

When finished, turn to next page for guidance on liabilities adjustments…

	F	H	I	J	K	L	M
1							
2							
3							
4							
5		**Pro Forma Balance Sheet**					
6			**Standalone**		Adjustments		
7			Acquirer	Target			
8	63,763.0		AAPL	DIS			
9	16,136.0		*6/28/14*	*6/28/14*	Increase	(Decr	
10	15,940.7	Cash and equivalents	164,490.0	6,948.0			171,438.0
11	119,555.6	Accounts receivable	10,788.0	7,543.0			18,331.0
12	1,395.8	Inventory	1,594.0	1,425.0			3,019.0
13	216,791.1	Deferred tax assets (current and long term)	3,884.0	480.0			4,364.0
14		Other current assets	13,878.0	1,667.0			15,545.0
15		PP&E	17,585.0	23,013.0			40,598.0
16	119,555.6	Intangible assets	3,767.0	7,268.0			11,035.0
17	79,703.7	Goodwill	2,374.0	27,924.0			30,298.0
18	16,136.0	Other assets	4,160.0	7,455.0			11,615.0
19	996.3	**Total assets**	**222,520.0**	**83,723.0**			**$306,243.0**
20	399.5	Accounts payable	20,535.0	6,379.0			26,914.0
21	216,791.1	Accrued expenses & def rev. (current & non-current)	26,718.0	3,756.0			30,474.0
22	Yes	Revolver and current debt	2,010.0	3,216.0			5,226.0
23		Long term debt	29,030.0	12,920.0			41,950.0
24		Convertible debt	0.0	0.0			0.0
25		Deferred tax liabilities	0.0	4,360.0			4,360.0
26		Other liabilities	23,287.0	4,480.0			27,767.0
27		Preferred stock	0.0	0.0			0.0
28	23,013.0	Noncontrolling interests	0.0	3,092.0			3,092.0
29	20%	Shareholders' equity	120,940.0	45,520.0			166,460.0
30	4,602.6	**Total liabilities + shareholder equity**	**$222,520.0**	**$83,723.0**			**$306,243.0**
31	20 years	*Balance check*	*0.0*	*0.0*			*0.0*

New acquirer debt: Capture all new debt raised to finance deal. Include both new debt raised to acquire target equity as well as to refinance target debt.

Refinanced target debt: We assumed DIS debt will be refinanced with new debt. Therefore, we must eliminate the DIS debt here. Make sure the formula does not eliminate DIS debt when target debt is assumed.

New acquirer DTLs are created in a stock sale. Reference from the write-up section

Prior target DTLs are significantly reduced or totally gone in asset deals – reference from write-up section.

When finished, turn to next page for guidance on equity adjustments…

	F	G	H	I	J	K	L	M
1								
2								
3								
4								
5			**Pro Forma Balance Sheet**					
6				**Standalone**		Adjustments		**Pro Forma**
7				Acquirer	Target			
8	63,763.0			AAPL	DIS			
9	16,136.0			*6/28/14*	*6/28/14*	Increase	(Decrease)	*6/28/14*
10	15,940.7		Cash and equivalents	164,490.0	6,948.0			171,438.0
11	119,555.6		Accounts receivable	10,788.0	7,543.0			18,331.0
12	1,395.8		Inventory	1,594.0	1,425.0			3,019.0
13	216,791.1		Deferred tax assets (current and long term)	3,884.0	480.0			4,364.0
14			Other current assets	13,878.0	1,667.0			15,545.0
15			PP&E	17,585.0	23,013.0			40,598.0
16	119,555.6		Intangible assets	3,767.0	7,268.0			11,035.0
17	79,703.7		Goodwill	2,374.0	27,924.0			30,298.0
18	16,136.0		Other assets	4,160.0	7,455.0			11,615.0
19	996.3		**Total assets**	**222,520.0**	**83,723.0**			**$306,243.0**
20	399.5		Accounts payable	20,535.0	6,379.0			26,914.0
21	216,791.1		Accrued expenses & def rev. (current & non-current)	26,718.0	3,756.0			30,474.0
22	Yes		Revolver and current debt	2,010.0	3,216.0			5,226.0
23			Long term debt	29,030.0	12,920.0			41,950.0
24			Convertible debt	0.0	0.0			0.0
25			Deferred tax liabilities	0.0	4,360.0			4,360.0
26			Other liabilities	23,287.0	4,480.0			27,767.0
27			Preferred stock	0.0	0.0			0.0
28	23,013.0		Noncontrolling interests	0.0	3,092.0			3,092.0
29	20%		Shareholders' equity	120,940.0	45,520.0			166,460.0
30	4,602.6		**Total liabilities + shareholder equity**	**$222,520.0**	**$83,723.0**			**$306,243.0**
31	20 years		*Balance check*	*0.0*	*0.0*			*0.0*

Target equity is eliminated.

Unlike financing fees, **Deal fees** are expensed as incurred so reduce equity by this amount.

AAPL's equity value is increased by the value of equity provided to DIS shareholders. Reference from sources & uses section.

Check your work

If you did everything correctly, your pro forma balance sheet should balance!

	G	H	I	J	K	L	M
4							
5		**Pro Forma Balance Sheet**					
6			**Standalone**		Adjustments		**Pro Forma**
7			Acquirer	Target			
8			AAPL	DIS			
9			*6/28/14*	*6/28/14*	Increase	(Decrease)	*6/28/14*
10		Cash and equivalents	164,490.0	6,948.0		(17,336.5)	154,101.5
11		Accounts receivable	10,788.0	7,543.0			18,331.0
12		Inventory	1,594.0	1,425.0			3,019.0
13		Deferred tax assets (current and long term)	3,884.0	480.0		(480.0)	3,884.0
14		Other current assets	13,878.0	1,667.0			15,545.0
15		PP&E	17,585.0	23,013.0	4,602.6		45,200.6
16		Intangible assets	3,767.0	7,268.0	11,301.5		22,336.5
17		Goodwill	2,374.0	27,924.0	170,685.4	(27,924.0)	173,059.4
18		Other assets	4,160.0	7,455.0			11,615.0
19		**Total assets**	**222,520.0**	**83,723.0**			**$447,091.9**
20		Accounts payable	20,535.0	6,379.0			26,914.0
21		Accrued expenses & def rev. (current & non-current)	26,718.0	3,756.0			30,474.0
22		Revolver and current debt	2,010.0	3,216.0		(3,216.0)	2,010.0
23		Long term debt	29,030.0	12,920.0	79,899.0	(12,920.0)	108,929.0
24		Convertible debt	0.0	0.0		0.0	0.0
25		Deferred tax liabilities	0.0	4,360.0	4,046.7	0.0	8,406.7
26		Other liabilities	23,287.0	4,480.0			27,767.0
27		Preferred stock	0.0	0.0			0.0
28		Noncontrolling interests	0.0	3,092.0			3,092.0
29		Shareholders' equity	120,940.0	45,520.0	119,555.6	(46,516.3)	239,499.3
30		**Total liabilities + shareholder equity**	**$222,520.0**	**$83,723.0**			**$447,091.9**
31		*Balance check*	*0.0*	*0.0*			*0.0*

Formula view

Increase	(Decrease)
	=-(F10+F12)
	=F48
=F30	
=F38+F20	
=F58	=-(J17)
	=IF($C$52="Refinanced",-J22,0)
=F9+F8	=IF($C$52="Refinanced",-J23,0)
	=IF($C$52="Refinanced",-J24,0)
=F53	=F52
=F11	=-J29-F19

Credit statistics:

Calculate AAPL and DIS credit stats <u>on a stand-alone basis</u> (leave pro forma stats blank for now)

Use the offer price when calculating DIS equity value

6		Standalone		Adjustments		Pro Forma
7		Acquirer	Target			
8		AAPL	DIS			
9		*6/28/14*	*6/28/14*	Increase	(Decrease)	*6/28/14*
10	Cash and equivalents	164,490.0	6,948.0		(17,336.5)	154,101.5
11	Accounts receivable	10,788.0	7,543.0			18,331.0
12	Inventory	1,594.0	1,425.0			3,019.0
13	Deferred tax assets (current and long term)	3,884.0	480.0		(480.0)	3,884.0
14	Other current assets	13,878.0	1,667.0			15,545.0
15	PP&E	17,585.0	23,013.0	4,602.6		45,200.6
16	Intangible assets	3,767.0	7,268.0	11,301.5		22,336.5
17	Goodwill	2,374.0	27,924.0	170,685.4	(27,924.0)	173,059.4
18	Other assets	4,160.0	7,455.0			11,615.0
19	**Total assets**	**222,520.0**	**83,723.0**			**$447,091.9**
20	Accounts payable	20,535.0	6,379.0			26,914.0
21	Accrued expenses & def rev. (current & non-current)	26,718.0	3,756.0			30,474.0
22	Revolver and current debt	2,010.0	3,216.0		(3,216.0)	2,010.0
23	Long term debt	29,030.0	12,920.0	79,899.0	(12,920.0)	108,929.0
24	Convertible debt	0.0	0.0		0.0	0.0
25	Deferred tax liabilities	0.0	4,360.0	4,046.7	0.0	8,406.7
26	Other liabilities	23,287.0	4,480.0			27,767.0
27	Preferred stock	0.0	0.0			0.0
28	Noncontrolling interests	0.0	3,092.0			3,092.0
29	Shareholders' equity	120,940.0	45,520.0	119,555.6	(46,516.3)	239,499.3
30	**Total liabilities + shareholder equity**	**$222,520.0**	**$83,723.0**			**$447,091.9**
31	*Balance check*	*0.0*	*0.0*			*0.0*
32						
33	*<u>Credit statistics</u>*	*AAPL*	*DIS*			*Pro Forma*
34	Total debt					
35	+ Noncontrolling interests					
36	+ Preferred stock					
37	- Cash & equivalents					
38	Net debt					
39						
40	Equity value (share price x shares out.)					
41	Enterprise value					
42	EBITDA for the calendar year ending 2014					
43	Gross Debt / EBITDA					
44	Enterprise value / EBITDA					
45	Debt / Equity					

Check your work

	G	H	I	J	K	L	M
4							
5		**Pro Forma Balance Sheet**					
6			**Standalone**		Adjustments		**Pro Forma**
7			Acquirer	Target			
8			AAPL	DIS			
9			*6/28/14*	*6/28/14*	Increase	(Decrease)	*6/28/14*
10		Cash and equivalents	164,490.0	6,948.0		(17,336.5)	154,101.5
11		Accounts receivable	10,788.0	7,543.0			18,331.0
12		Inventory	1,594.0	1,425.0			3,019.0
13		Deferred tax assets (current and long term)	3,884.0	480.0		(480.0)	3,884.0
14		Other current assets	13,878.0	1,667.0			15,545.0
15		PP&E	17,585.0	23,013.0	4,602.6		45,200.6
16		Intangible assets	3,767.0	7,268.0	11,301.5		22,336.5
17		Goodwill	2,374.0	27,924.0	170,685.4	(27,924.0)	173,059.4
18		Other assets	4,160.0	7,455.0			11,615.0
19		**Total assets**	**222,520.0**	**83,723.0**			**$447,091.9**
20		Accounts payable	20,535.0	6,379.0			26,914.0
21		Accrued expenses & def rev. (current & non-current)	26,718.0	3,756.0			30,474.0
22		Revolver and current debt	2,010.0	3,216.0		(3,216.0)	2,010.0
23		Long term debt	29,030.0	12,920.0	79,899.0	(12,920.0)	108,929.0
24		Convertible debt	0.0	0.0		0.0	0.0
25		Deferred tax liabilities	0.0	4,360.0	4,046.7	0.0	8,406.7
26		Other liabilities	23,287.0	4,480.0			27,767.0
27		Preferred stock	0.0	0.0			0.0
28		Noncontrolling interests	0.0	3,092.0			3,092.0
29		Shareholders' equity	120,940.0	45,520.0	119,555.6	(46,516.3)	239,499.3
30		**Total liabilities + shareholder equity**	**$222,520.0**	**$83,723.0**			**$447,091.9**
31		*Balance check*	*0.0*	*0.0*			*0.0*
32							
33		*Credit statistics*	*AAPL*	*DIS*			*Pro Forma*
34		Total debt	31,040.0	16,136.0			
35		+ Noncontrolling interests	0.0	3,092.0			
36		+ Preferred stock	0.0	0.0			
37		- Cash & equivalents	(164,490.0)	(6,948.0)			
38		Net debt	(133,450.0)	12,280.0			
39							
40		Equity value (share price x shares out.)	592,362.2	199,259.3			
41		Enterprise value	458,912.2	211,539.3			
42		EBITDA for the calendar year ending 2014	61,615.0	14,307.0			
43		Gross Debt / EBITDA	0.5x	1.3x			
44		Enterprise value / EBITDA	7.4x	14.8x			
45		Debt / Equity	5.2%	9.6%			

Formula view

=I23+I24+I22	=J23+J24+J22
=I28	=J28
=I27	=J27
=-I10	=-J10
=SUM(I34:I37)	=SUM(J34:J37)
=C15*Shares!K14	=C24*C25
=I40+I38	=J40+J38
=C40	=C41
=SUM(I34:I36)/I42	=SUM(J34:J36)/J42
=I41/I42	=J41/J42
=SUM(I34:I36)/I40	=SUM(J34:J36)/J40

Complete the pro forma credit statistics

		Standalone		Adjustments		Pro Forma
Pro Forma Balance Sheet						
		Acquirer	Target			
		AAPL	DIS			
		6/28/14	*6/28/14*	Increase	(Decrease)	*6/28/14*
Cash and equivalents		164,490.0	6,948.0		(17,336.5)	154,101.5
Accounts receivable		10,788.0	7,543.0			18,331.0
Inventory		1,594.0	1,425.0			3,019.0
Deferred tax assets (current and long term)		3,884.0	480.0		(480.0)	3,884.0
Other current assets		13,878.0	1,667.0			15,545.0
PP&E		17,585.0	23,013.0	4,602.6		45,200.6
Intangible assets		3,767.0	7,268.0	11,301.5		22,336.5
Goodwill		2,374.0	27,924.0	170,685.4	(27,924.0)	173,059.4
Other assets		4,160.0	7,455.0			11,615.0
Total assets		**222,520.0**	**83,723.0**			**$447,091.9**
Accounts payable		20,535.0	6,379.0			26,914.0
Accrued expenses & def rev. (current & non-current)		26,718.0	3,756.0			30,474.0
Revolver and current debt		2,010.0	3,216.0		(3,216.0)	2,010.0
Long term debt		29,030.0	12,920.0	79,899.0	(12,920.0)	108,929.0
Convertible debt		0.0	0.0		0.0	0.0
Deferred tax liabilities		0.0	4,360.0	4,046.7	0.0	8,406.7
Other liabilities		23,287.0	4,480.0			27,767.0
Preferred stock		0.0	0.0			0.0
Noncontrolling interests		0.0	3,092.0			3,092.0
Shareholders' equity		120,940.0	45,520.0	119,555.6	(46,516.3)	239,499.3
Total liabilities + shareholder equity		**$222,520.0**	**$83,723.0**			**$447,091.9**
Balance check		*0.0*	*0.0*			*0.0*
Credit statistics		*AAPL*	*DIS*			*Pro Forma*
Total debt		31,040.0	16,136.0			
+ Noncontrolling interests		0.0	3,092.0			
+ Preferred stock		0.0	0.0			
- Cash & equivalents		(164,490.0)	(6,948.0)			
Net debt		(133,450.0)	12,280.0			
Equity value (share price x shares out.)		592,362.2	199,259.3			
Enterprise value		458,912.2	211,539.3			
EBITDA for the calendar year ending 2014		61,615.0	14,307.0			
Gross Debt / EBITDA		0.5x	1.3x			
Enterprise value / EBITDA		7.4x	14.8x			
Debt / Equity		5.2%	9.6%			

Pro forma refers to acquirer's financials combined with the target's. For example, the pro forma equity value represents Apple's new market cap based on how many shares are now outstanding given the new stock issuance and assuming Apple's price doesn't change (that assumption in itself is the very thing this analysis will (shortly) shed light on via the accretion/dilution analysis).

Check your work

	Pro Forma Balance Sheet	I	J	K	L	M
6		Standalone		Adjustments		Pro Forma
7		Acquirer	Target			
8		AAPL	DIS			
9		6/28/14	6/28/14	Increase	(Decrease)	6/28/14
10	Cash and equivalents	164,490.0	6,948.0		(17,336.5)	154,101.5
11	Accounts receivable	10,788.0	7,543.0			18,331.0
12	Inventory	1,594.0	1,425.0			3,019.0
13	Deferred tax assets (current and long term)	3,884.0	480.0		(480.0)	3,884.0
14	Other current assets	13,878.0	1,667.0			15,545.0
15	PP&E	17,585.0	23,013.0	4,602.6		45,200.6
16	Intangible assets	3,767.0	7,268.0	11,301.5		22,336.5
17	Goodwill	2,374.0	27,924.0	170,685.4	(27,924.0)	173,059.4
18	Other assets	4,160.0	7,455.0			11,615.0
19	**Total assets**	**222,520.0**	**83,723.0**			**$447,091.9**
20	Accounts payable	20,535.0	6,379.0			26,914.0
21	Accrued expenses & def rev. (current & non-current)	26,718.0	3,756.0			30,474.0
22	Revolver and current debt	2,010.0	3,216.0		(3,216.0)	2,010.0
23	Long term debt	29,030.0	12,920.0	79,899.0	(12,920.0)	108,929.0
24	Convertible debt	0.0	0.0		0.0	0.0
25	Deferred tax liabilities	0.0	4,360.0	4,046.7	0.0	8,406.7
26	Other liabilities	23,287.0	4,480.0			27,767.0
27	Preferred stock	0.0	0.0			0.0
28	Noncontrolling interests	0.0	3,092.0			3,092.0
29	Shareholders' equity	120,940.0	45,520.0	119,555.6	(46,516.3)	239,499.3
30	**Total liabilities + shareholder equity**	**$222,520.0**	**$83,723.0**			**$447,091.9**
31	*Balance check*	*0.0*	*0.0*			*0.0*
32						
33	*Credit statistics*	*AAPL*	*DIS*			*Pro Forma*
34	Total debt	31,040.0	16,136.0			110,939.0
35	+ Noncontrolling interests	0.0	3,092.0			3,092.0
36	+ Preferred stock	0.0	0.0			0.0
37	- Cash & equivalents	(164,490.0)	(6,948.0)			(154,101.5)
38	Net debt	(133,450.0)	12,280.0			(40,070.5)
39						
40	Equity value (share price x shares out.)	592,362.2	199,259.3			711,917.8
41	Enterprise value	458,912.2	211,539.3			671,847.3
42	EBITDA for the calendar year ending 2014	61,615.0	14,307.0			75,922.0
43	Gross Debt / EBITDA	0.5x	1.3x			1.5x
44	Enterprise value / EBITDA	7.4x	14.8x			8.8x
45	Debt / Equity	5.2%	9.6%			16.0%

Formula view

=M23+M24+M22
=M28
=M27
=-M10
=SUM(M34:M37)
=C15*(Shares!K14+Model!C32)
=M40+M38
=SUM(I42:J42)
=SUM(M34:M36)/M42
=M41/M42
=SUM(M34:M36)/M40

Let's Model

The following modeling steps cover:

- Building an accretion dilution analysis
- Sensitivity analysis
- Cash vs. GAAP EPS
- Calendarization

Open the following files to begin:

- Accretion_Dilution_Model_Empty.xlsx
- Consensus IS Factset Quarterly (A&D)
- Consensus IS Factset Annual (A&D)
- Consensus EPS Factset Quarterly (A&D)
- Consensus EPS Factset Annual (A&D)

We can now start the accretion / dilution analysis

1. First we need net income and **GAAP EPS** forecasts for the next 3 years for both acquirer and target
2. Services like Factset and CIQ provide consensus forecasts for EPS and usually for net income

Walt Disney Company (DIS) — **$91.01**

Next Rpt Date:13 Nov '14 — Data as of: 04-Sep-2014

ALL ESTIMATES — Latest | 100 Day Mean

Earnings Per Share

	FY '12	FY '13	Q1 '14	Q2 '14	Q3 '14	Q4 '14E	FY '14E	Q1 '15E	Q2 '15E	Q3 '15E	Q4 '15E	FY '15E	FY '16E
	SEP '12	SEP '13	DEC '13	MAR '14	JUN '14	SEP '14	SEP '14	DEC '14	MAR '15	JUN '15	SEP '15	SEP '15	SEP '16
EPS	3.07	3.39	1.04	1.11	1.28	0.88	4.30	1.09	1.11	1.40	1.07	4.70	5.42
Sharp Consensus	-	-	-	-	-	-	4.32	-	-	-	-	-	-
EPS - GAAP	3.13	3.38	1.03	1.08	1.28	0.88	4.27	1.09	1.10	1.37	1.09	4.70	5.42
EPS - Non GAAP	3.07	3.39	1.04	1.11	1.28	0.88	4.30	1.09	1.11	1.40	1.07	4.70	5.42

Estimates Database: FactSet Estimates

Income Statement (M)

	FY '12	FY '13	Q1 '14	Q2 '14	Q3 '14	Q4 '14E	FY '14E	Q1 '15E	Q2 '15E	Q3 '15E	Q4 '15E	FY '15E	FY '16E
	SEP '12	SEP '13	DEC '13	MAR '14	JUN '14	SEP '14	SEP '14	DEC '14	MAR '15	JUN '15	SEP '15	SEP '15	SEP '16
Sales	42,278	45,041	12,309	11,649	12,466	12,337	48,749	12,901	12,050	13,117	13,437	51,692	55,735
EBITDA	11,258	12,171	3,284	3,666	4,143	3,097	14,244	3,401	3,493	4,298	3,544	15,128	16,656
Operating Income	9,490	10,166	2,904	3,198	3,720	2,633	12,486	3,038	3,258	3,817	2,993	13,352	15,101
Pretax Income	9,260	9,620	2,940	3,175	3,670	2,532	12,321	2,965	3,083	3,814	3,014	12,985	14,524
Tax Expense	-	2,984	1,036	1,119	1,251	862	4,261	1,036	1,063	1,322	1,044	4,437	4,979
Net Income	5,682	6,136	1,840	1,917	2,245	1,517	7,530	1,878	1,888	2,354	1,834	8,013	8,958

Estimates Database: FactSet Estimates

We can now get started on the accretion / dilution analysis

1. First we need net income and **GAAP EPS** forecasts for the next 3 years for both acquirer and target
2. Services like Factset and CIQ provide consensus forecasts for EPS and usually for net income

Apple Inc. (AAPL) $99.78

Next Rpt Date:20 Oct '14 Data as of: 04-Sep-2014

ALL ESTIMATES Latest | 100 Day Mean

Earnings Per Share

	FY '12	FY '13	Q1 '14	Q2 '14	Q3 '14	Q4 '14E	FY '14E	Q1 '15E	Q2 '15E	Q3 '15E	Q4 '15E	FY '15E	FY '16E
	SEP '12	SEP '13	DEC '13	MAR '14	JUN '14	SEP '14	SEP '14	DEC '14	MAR '15	JUN '15	SEP '15	SEP '15	SEP '16
EPS	6.31	5.68	2.07	1.66	1.28	1.29	6.31	2.34	1.78	1.42	1.48	7.00	7.70
EPS - GAAP	6.31	5.68	2.07	1.66	1.28	1.29	6.31	2.34	1.78	1.42	1.48	7.00	7.70
EPS - Non GAAP	6.31	5.68	2.07	1.66	1.28	1.30	6.30	2.32	1.75	1.38	1.43	6.96	7.72
EPS - Non GAAP ex. SOE	6.57	6.02	2.18	1.77	1.40	1.40	6.49	2.40	1.83	1.49	1.53	7.00	7.29

Estimates Database: FactSet Estimates

Income Statement (M)

	FY '12	FY '13	Q1 '14	Q2 '14	Q3 '14	Q4 '14E	FY '14E	Q1 '15E	Q2 '15E	Q3 '15E	Q4 '15E	FY '15E	FY '16E
	SEP '12	SEP '13	DEC '13	MAR '14	JUN '14	SEP '14	SEP '14	DEC '14	MAR '15	JUN '15	SEP '15	SEP '15	SEP '16
Sales	156,508	170,910	57,594	45,646	37,432	39,652	180,385	62,641	49,419	41,888	43,561	197,228	206,157
Guidance (Low)	-	-	55,000	42,000	36,000	37,000	-	-	-	-	-	-	-
Guidance (High)	-	-	58,000	44,000	38,000	40,000	-	-	-	-	-	-	-
Gross Income	68,662	64,304	21,846	17,947	14,735	15,113	69,618	23,560	18,827	15,843	16,485	74,796	78,244
Guidance (Low)	-	-	20,075	15,540	13,320	13,690	-	-	-	-	-	-	-
Guidance (High)	-	-	21,750	16,720	14,440	15,200	-	-	-	-	-	-	-
EBITDA	58,518	55,756	19,607	15,480	12,228	12,230	59,335	21,677	16,418	13,542	13,618	65,296	70,008
Operating Income	55,241	48,999	17,463	13,593	10,282	10,372	51,544	18,391	13,916	11,044	11,369	55,160	58,069
Pretax Income	55,763	50,155	17,709	13,818	10,484	10,533	52,448	18,584	14,136	11,268	11,583	55,938	58,852
Tax Expense	-	13,118	4,637	3,595	2,736	2,754	13,708	4,878	3,713	2,919	3,029	14,524	15,258
Net Income	41,733	37,037	13,072	10,223	7,748	7,852	38,973	13,948	10,514	8,317	8,632	41,465	43,889

We can now get started on the accretion / dilution analysis!

1. Input net income and GAAP EPS forecasts provided by Factset for both acquirer and target
2. Back into the implied diluted shares outstanding for both acquirer and target

		FY 2014	FY 2015	FY 2016
47	**Accretion / Dilution Analysis**			
48				
49	*EPS Accounting:*	**FY 2014**	**FY 2015**	**FY 2016**
50		9/28/2014	9/30/2015	9/30/2016
51	*Acquirer*			
52	Net income			
53	GAAP EPS			
54	Diluted shares outstanding (weighted avg.)			
55	*Target*			
56	Net income			
57	GAAP EPS			
58	Diluted shares outstanding (weighted avg.)			
59				
60	Transaction related expenses/income[1]			
61	Less: Interest expense from new deal debt			
62	Less: Interest income on cash forgone			
63	Plus: Synergies			
64	Less: Incremental D&A expense			
65	Less: Financing fee amortization			
66	Taxes (assumed at acquirer's rate)			
67	**Total after tax transaction related income/ (expenses)**			
68				
69	**Pro Forma GAAP EPS**			
70	Pro Forma Shares Outstanding			
71				
72	Pro forma GAAP EPS			
73	Acquirer standalone EPS			
74	**Accretion / Dilution per share**			
75	Accretion / Dilution %			
76	Additional pretax synergies required to breakeven			
77	[1] One-time charges are excluded from GAAP EPS calculations in this model			

1. Check your work
2. Calculate all the pre-tax deal related adjustments that would affect the pro forma income statement

Accretion / Dilution Analysis			
EPS Accounting:	**FY 2014**	**FY 2015**	**FY 2016**
	9/28/2014	9/30/2015	9/30/2016
Acquirer			
Net income	38,973.0	41,465.0	43,889.0
GAAP EPS	6.31	7.00	7.70
Diluted shares outstanding (weighted avg.)	6,176.4	5,923.6	5,699.9
Target			
Net income	7,530.0	8,013.0	8,958.0
GAAP EPS	4.27	4.70	5.42
Diluted shares outstanding (weighted avg.)	1,763.5	1,704.9	1,652.8
Transaction related expenses/income[1]			
Less: Interest expense from new deal debt			
Less: Interest income on cash forgone			
Plus: Synergies			
Less: Incremental D&A expense			
Less: Financing fee amortization			
Taxes (assumed at acquirer's rate)			
Total after tax transaction related income/ (expenses)			
Pro Forma GAAP EPS			
Pro Forma Shares Outstanding			
Pro forma GAAP EPS			
Acquirer standalone EPS			
Accretion / Dilution per share			
Accretion / Dilution %			
Additional pretax synergies required to breakeven			

[1] One-time charges are excluded from both cash and GAAP EPS calculations in this model

1. Check your work
2. Determine accretion/dilution

	H	K	L	M
46				
47	**Accretion / Dilution Analysis**			
48				
49	*EPS Accounting:*	**FY 2014**	**FY 2015**	**FY 2016**
50		9/28/2014	9/30/2015	9/30/2016
51	*Acquirer*			
52	Net income	38,973.0	41,465.0	43,889.0
53	GAAP EPS	6.31	7.00	7.70
54	Diluted shares outstanding (weighted avg.)	6,176.4	5,923.6	5,699.9
55	*Target*			
56	Net income	7,530.0	8,013.0	8,958.0
57	GAAP EPS	4.27	4.70	5.42
58	Diluted shares outstanding (weighted avg.)	1,763.5	1,704.9	1,652.8
59				
60	Transaction related expenses/income[1]			
61	Less: Interest expense from new deal debt	(2,550.5)	(2,550.5)	(2,550.5)
62	Less: Interest income on cash forgone	(173.4)	(173.4)	(173.4)
63	Plus: Synergies	100.0	100.0	100.0
64	Less: Incremental D&A expense	(956.9)	(956.9)	(956.9)
65	Less: Financing fee amortization	(79.9)	(79.9)	(79.9)
66	Taxes (assumed at acquirer's rate)	955.4	955.4	955.4
67	**Total after tax transaction related income/ (expenses)**	**(2,705.3)**	**(2,705.3)**	**(2,705.3)**
68				
69	**Pro Forma GAAP EPS**	**43,797.7**	**46,772.7**	**50,141.7**
70	Pro Forma Shares Outstanding	7,387.0	7,134.1	6,910.4
71				
72	Pro forma GAAP EPS			
73	Acquirer standalone EPS			
74	**Accretion / Dilution per share**			
75	Accretion / Dilution %			
76	Additional pretax synergies required to breakeven			
77	[1] One-time charges are excluded from both cash and GAAP EPS calculations in this model			
78				

Formula view

=-($C$64*SUM($K$22:$K$24,$L$22:$L$24))	=-($C$64*SUM($K$22:$K$24,$L$22:$L$24))	=-($C$64*SUM($K$22:$K$24,$L$22:$L$24))
=$C$65*$L$10	=$C$65*$L$10	=$C$65*$L$10
=$C$39	=$C$39	=$C$39
=-($F$32+$F$40)	=-($F$32+$F$40)	=-($F$32+$F$40)
=-($C$62)	=-($C$62)	=-($C$62)
=-(SUM(K61:K65)*$C$42)	=-(SUM(L61:L65)*$C$42)	=-(SUM(M61:M65)*$C$42)
=SUM(K61:K66)	**=SUM(L61:L66)**	**=SUM(M61:M66)**
=K52+K56+K67	**=L52+L56+L67**	**=M52+M56+M67**
=K54+$C$32	=L54+$C$32	=M54+$C$32

1. Check your work
2. Determine accretion/dilution

Accretion / Dilution Analysis

	FY 2014	FY 2015	FY 2016
EPS Accounting:	9/28/2014	9/30/2015	9/30/2016
Acquirer			
Net income	38,973.0	41,465.0	43,889.0
GAAP EPS	6.31	7.00	7.70
Diluted shares outstanding (weighted avg.)	6,176.4	5,923.6	5,699.9
Target			
Net income	7,530.0	8,013.0	8,958.0
GAAP EPS	4.27	4.70	5.42
Diluted shares outstanding (weighted avg.)	1,763.5	1,704.9	1,652.8
Transaction related expenses/income[1]			
Less: Interest expense from new deal debt	(2,550.5)	(2,550.5)	(2,550.5)
Less: Interest income on cash forgone	(173.4)	(173.4)	(173.4)
Plus: Synergies	100.0	100.0	100.0
Less: Incremental D&A expense	(956.9)	(956.9)	(956.9)
Less: Financing fee amortization	(79.9)	(79.9)	(79.9)
Taxes (assumed at acquirer's rate)	955.4	955.4	955.4
Total after tax transaction related income/ (expenses)	**(2,705.3)**	**(2,705.3)**	**(2,705.3)**
Pro Forma GAAP EPS	**43,797.7**	**46,772.7**	**50,141.7**
Pro Forma Shares Outstanding	7,387.0	7,134.1	6,910.4
Pro forma GAAP EPS	$5.93	$6.56	$7.26
Acquirer standalone EPS	$6.31	$7.00	$7.70
Accretion / Dilution per share	***($0.38)***	***($0.44)***	***($0.44)***
Accretion / Dilution %	*(6.0%)*	*(6.3%)*	*(5.8%)*
Additional pretax synergies required to breakeven	=MAX(0,-(K74*K70/(1-$C$42)))	4,284.5	4,152.4

- **The deal looks quite dilutive** given the assumptions we made.
- Building **sensitivity analysis** using data tables enables the acquirer to analyze how various pricing options and assumptions ultimately affect accretion/dilution
- What inputs will the acquirer seek to sensitize?

Sensitivity Analysis

Accretion Dilution - Year 1

Relevant assumptions	% Stock	Offer price			
Current offer price	($0.38)	$95.00	$105.00	$115.00	$125.00
$113.00	100%	(0.48)	(0.61)	(0.74)	(0.86)
Current % stock	75%	(0.30)	(0.42)	(0.54)	(0.65)
60.0%	50%	(0.09)	(0.20)	(0.31)	(0.41)
% Cash consideration financed with debt	25%	0.15	0.05	(0.04)	(0.13)
80.0%	0%	0.42	0.34	0.27	0.19

Accretion Dilution - Year 2

Relevant assumptions	% Stock	Offer price			
Current offer price	($0.44)	$95.00	$105.00	$115.00	$125.00
$113.00	100%	(0.59)	(0.74)	(0.88)	(1.01)
Current % stock	75%	(0.36)	(0.50)	(0.63)	(0.76)
40.0%	50%	(0.11)	(0.23)	(0.35)	(0.47)
% Cash consideration financed with debt	25%	0.18	0.08	(0.02)	(0.12)
20.0%	0%	0.52	0.44	0.36	0.28

Accretion Dilution - Year 3

Relevant assumptions	% Stock	Offer price			
Current offer price	($0.44)	$95.00	$105.00	$115.00	$125.00
$113.00	100%	(0.64)	(0.81)	(0.97)	(1.12)
Current % stock	75%	(0.37)	(0.52)	(0.67)	(0.82)
60.0%	50%	(0.06)	(0.19)	(0.33)	(0.46)
% Cash consideration financed with debt	25%	0.30	0.18	0.07	(0.04)
80.0%	0%	0.70	0.62	0.54	0.46

Accretion Dilution - Year 1

Relevant assumptions	% Stock	% Cash consideration financed with debt			
Current offer price	($0.38)	0%	25%	50%	100%
$113.00	100%	(0.71)	(0.71)	(0.71)	(0.71)
Current % stock	75%	(0.40)	(0.43)	(0.47)	(0.54)
60.0%	50%	(0.03)	(0.11)	(0.19)	(0.35)
% Cash consideration financed with debt	25%	0.39	0.26	0.13	(0.13)
80.0%	0%	0.87	0.69	0.50	0.13

- **Offer price** is a key determinant of accretion/dilution
- Depending on the relative costs of capital, **financing the deal** with excess cash vs. new debt vs. equity yields significantly different results and often contributes to management's decision about the optimal form of consideration

- In addition to accretion/dilution, acquirers are also often concerned with the impact of an acquisition on their capital structure and credit profile.
- A sensitivity analysis can also illuminate how pro forma leverage is impacted by the structure of the deal
- Here we see specifically how higher debt financing affects Apple's pro forma debt/EBITDA – a critical debt capacity ratio

	G	H	I	J	K	L	M
108		80.0%	0%	0.70	0.62	0.54	0.46
109							
110							
111		**Accretion Dilution - Year 1**					
112		Relevant assumptions	% Stock	% Cash consideration financed with debt			
113		Current offer price	($0.38)	0%	25%	50%	100%
114		$113.00	100%	(0.71)	(0.71)	(0.71)	(0.71)
115		Current % stock	75%	(0.40)	(0.43)	(0.47)	(0.54)
116		60.0%	50%	(0.03)	(0.11)	(0.19)	(0.35)
117		% Cash consideration financed with debt	25%	0.39	0.26	0.13	(0.13)
118		80.0%	0%	0.87	0.69	0.50	0.13
119							
120							
121		**Debt / LTM EBITDA multiple**					
122		Relevant assumptions	% Stock	Offer price			
123		Current offer price	1.502x	$95.00	$105.00	$115.00	$125.00
124		$113.00	100%	0.662x	0.662x	0.662x	0.662x
125		Current % stock	75%	1.103x	1.150x	1.196x	1.243x
126		60.0%	50%	1.544x	1.637x	1.731x	1.824x
127		% Cash consideration financed with debt	25%	1.984x	2.125x	2.265x	2.405x
128		80.0%	0%	2.425x	2.612x	2.799x	2.986x

GAAP EPS vs. Cash (Non GAAP) EPS

- For many companies and industries, analysts often look at – and place more weight on – "cash" or "non-GAAP" EPS – a measure that ignores certain non-cash items, notably certain D&A and SBC expenses.
- Factset (and CIQ, etc.) usually provide consensus non-GAAP EPS forecasts in addition to GAAP.
- The conceptual challenge with non-GAAP is consistency: What is ignored (i.e. certain amortization expense, SBC, etc.) must be consistently excluded for both acquirer and target.

51	*Acquirer*			
52	Net income	38,973.0	41,465.0	43,889.0
53	GAAP EPS	6.31	7.00	7.70
54	Diluted shares outstanding (weighted avg.)	6,176.4	5,923.6	5,699.9
55	*Target*			
56	Net income	7,530.0	8,013.0	8,958.0
57	GAAP EPS	4.27	4.70	5.42
58	Diluted shares outstanding (weighted avg.)	1,763.5	1,704.9	1,652.8
59				
60	Transaction related expenses/income[1]			
61	Less: Interest expense from new deal debt	(2,550.5)	(2,550.5)	(2,550.5)
62	Less: Interest income on cash forgone	(173.4)	(173.4)	(173.4)
63	Plus: Synergies	100.0	100.0	100.0
64	Less: Incremental D&A expense	(956.9)	(956.9)	(956.9)
65	Less: Financing fee amortization	(79.9)	(79.9)	(79.9)
66	Taxes (assumed at acquirer's rate)	955.4	955.4	955.4
67	**Total after tax transaction related income/ (expenses)**	**(2,705.3)**	**(2,705.3)**	**(2,705.3)**
68				
69	**Pro Forma GAAP EPS**	**43,797.7**	**46,772.7**	**50,141.7**
70	Pro Forma Shares Outstanding	7,387.0	7,134.1	6,910.4
71				
72	Pro forma GAAP EPS	$5.93	$6.56	$7.26
73	Acquirer standalone EPS	$6.31	$7.00	$7.70
74	**Accretion / Dilution per share**	***($0.38)***	***($0.44)***	***($0.44)***
75	Accretion / Dilution %	*(6.0%)*	*(6.3%)*	*(5.8%)*
76	Additional pretax synergies required to breakeven	3,807.8	4,284.5	4,152.4
77	[1] One-time charges are excluded from both cash and GAAP EPS calculations in this model			

Clearly identify the type of EPS desired

- Create a dropdown as illustrated

46					
47	**Accretion / Dilution Analysis**				
48					
49	*EPS Accounting:*	GAAP EPS	**FY 2014**	**FY 2015**	**FY 2016**
50		GAAP EPS / Cash EPS	9/28/2014	9/30/2015	9/30/2016
51	*Acquirer*				
52	Net income		38,973.0	41,465.0	43,889.0
53	GAAP EPS		6.31	7.00	7.70
54	Diluted shares outstanding (weighted avg.)		6,176.4	5,923.6	5,699.9
55	*Target*				
56	Net income		7,530.0	8,013.0	8,958.0
57	GAAP EPS		4.27	4.70	5.42
58	Diluted shares outstanding (weighted avg.)		1,763.5	1,704.9	1,652.8
59					
60	Transaction related expenses/income[1]				
61	Less: Interest expense from new deal debt		(2,550.5)	(2,550.5)	(2,550.5)
62	Less: Interest income on cash forgone		(173.4)	(173.4)	(173.4)
63	Plus: Synergies		100.0	100.0	100.0
64	Less: Incremental D&A expense		(956.9)	(956.9)	(956.9)
65	Less: Financing fee amortization		(79.9)	(79.9)	(79.9)
66	Taxes (assumed at acquirer's rate)		955.4	955.4	955.4
67	**Total after tax transaction related income/ (expenses)**		**(2,705.3)**	**(2,705.3)**	**(2,705.3)**
68					
69	**Pro Forma GAAP EPS**		**43,797.7**	**46,772.7**	**50,141.7**
70	Pro Forma Shares Outstanding		7,387.0	7,134.1	6,910.4
71					
72	Pro forma GAAP EPS		$5.93	$6.56	$7.26
73	Acquirer standalone EPS		$6.31	$7.00	$7.70
74	**Accretion / Dilution per share**		***($0.38)***	***($0.44)***	***($0.44)***
75	Accretion / Dilution %		*(6.0%)*	*(6.3%)*	*(5.8%)*
76	Additional pretax synergies required to breakeven		3,807.8	4,284.5	4,152.4
77	[1] One-time charges are excluded from both cash and GAAP EPS calculations in this model				

We don't want cash EPS in this case study, but keep in mind that if we did, you would need to replace Factset's GAAP estimates with the non-GAAP estimates

Create dynamic row headers so that they say 'Cash EPS' instead of 'GAAP EPS' when the 'Cash EPS' option is selected

Insert an IF statement that ignores non-cash deal adjustments when cash EPS is selected

Check your work

			FY 2014	FY 2015	FY 2016
Accretion / Dilution Analysis					
EPS Accounting:	Cash EPS		FY 2014	FY 2015	FY 2016
			9/28/2014	9/30/2015	9/30/2016
Acquirer					
Net income			38,973.0	41,465.0	43,889.0
Cash EPS			6.31	7.00	7.70
Diluted shares outstanding (weighted avg.)			6,176.4	5,923.6	5,699.9
Target					
Net income			7,530.0	8,013.0	8,958.0
Cash EPS			4.27	4.70	5.42
Diluted shares outstanding (weighted avg.)			1,763.5	1,704.9	1,652.8
Transaction related expenses/income[1]					
Less: Interest expense from new deal debt			(2,550.5)	(2,550.5)	(2,550.5)
Less: Interest income on cash forgone			(173.4)	(173.4)	(173.4)
Plus: Synergies			100.0	100.0	100.0
Less: Incremental D&A expense			0.0	0.0	0.0
Less: Financing fee amortization			0.0	0.0	0.0
Taxes (assumed at acquirer's rate)			684.8	684.8	684.8
Total after tax transaction related income/ (expenses)			**(1,939.1)**	**(1,939.1)**	**(1,939.1)**
Pro Forma Cash EPS			**44,563.9**	**47,538.9**	**50,907.9**
Pro Forma Shares Outstanding			7,387.0	7,134.1	6,910.4
Pro forma Cash EPS			$6.03	$6.66	$7.37
Acquirer standalone EPS			$6.31	$7.00	$7.70
Accretion / Dilution per share			***($0.28)***	***($0.34)***	***($0.33)***
Accretion / Dilution %			*(4.4%)*	*(4.8%)*	*(4.3%)*
Additional pretax synergies required to breakeven			2,770.9	3,247.7	3,115.6

[1] One-time charges are excluded from both cash and GAAP EPS calculations in this model

Switch the toggle back to GAAP EPS when finished checking your work

Calendarization

- Recall that in order to determine accretion/dilution, we had to combine AAPL and DIS net incomes
- Did you notice that we happened to get lucky that AAPL and DIS both have the same fiscal year-end date?
- When acquirer and target don't have the same fiscal year-end, we need to "calendarize" target's EPS and net income forecasts to match the acquirer's fiscal year end

	G	H	I	J	K	L	M
46							
47		**Accretion / Dilution Analysis**					
48							
49		*EPS Accounting:*	**GAAP EPS**		**FY 2014**	**FY 2015**	**FY 2016**
50					9/28/2014	9/30/2015	9/30/2016
51		*Acquirer*					
52		Net income			38,973.0	41,465.0	43,889.0
53		GAAP EPS			6.31	7.00	7.70
54		Diluted shares outstanding (weighted avg.)			6,176.4	5,923.6	5,699.9
55		*Target*					
56		Net income			7,530.0	8,013.0	8,958.0
57		GAAP EPS			4.27	4.70	5.42
58		Diluted shares outstanding (weighted avg.)			1,763.5	1,704.9	1,652.8
59							

Review the Calendarization tab

Because quarterly consensus forecasts are usually not reliably available beyond two years, we have to input acquirer's annual EPS and net income forecasts for 3 years and then input target forecasts that fully overlap with that period.

Calendarization

In millions, except per share data

	Last actual FYE
Apple	FYE Sep-13
Disney	FYE Sep-13

Calendarization	
% of EPS used from prior period	0%
% of EPS used from current period	100%
% of EPS used from next period	0%

Apple		*Disney*		*Disney adjusted to Apple FYE*	
Fiscal year end	EPS forecast	*Fiscal year end*	EPS Forecast	*Fiscal year end*	EPS forecast
		Sep-13	3.38		
Sep-14	6.31	Sep-14	4.27	Sep-14	4.27
Sep-15	7.00	Sep-15	4.70	Sep-15	4.70
Sep-16	7.70	Sep-16	5.42	Sep-16	5.42
		Sep-17	6.21		
	Net income forecast		Net income forecast		Net income forecast
		Sep-13	6,136.0		
Sep-14	38,973.0	Sep-14	7,530.0	Sep-14	7,530.0
Sep-15	41,465.0	Sep-15	8,013.0	Sep-15	8,013.0
Sep-16	43,889.0	Sep-16	8,958.0	Sep-16	8,958.0
		Sep-17	10,256.9		

Modify the main model to reference target EPS and net income from the calendarization tab
Since AAPL and DIS have the same FYE, there is no difference between DIS fiscal year forecasts and the forecasts calendarized to AAPL's FYE and thus no impact on the model in this particular case study.

	G	H	I	J	K	L	M	N
46								
47		**Accretion / Dilution Analysis**						
48								
49		*EPS Accounting:*	GAAP EPS		**FY 2014**	**FY 2015**	**FY 2016**	
50					9/28/2014	9/30/2015	9/30/2016	
51		*Acquirer*						
52		Net income			38,973.0	41,465.0	43,889.0	
53		GAAP EPS			6.31	7.00	7.70	
54		Diluted shares outstanding (weighted avg.)			6,176.4	5,923.6	5,699.9	
55		*Target*						
56		Net income			7,530.0	8,013.0	=Calendarization!I21	
57		GAAP EPS			$4.27	$4.70	$5.42	
58		Diluted shares outstanding (weighted avg.)			1,763.5	1,704.9	1,652.8	
59								
60		Transaction related expenses/income[1]						
61		Less: Interest expense from new deal debt			(2,550.5)	(2,550.5)	(2,550.5)	
62		Less: Interest income on cash forgone			(173.4)	(173.4)	(173.4)	
63		Plus: Synergies			100.0	100.0	100.0	
64		Less: Incremental D&A expense			(956.9)	(956.9)	(956.9)	
65		Less: Financing fee amortization			(79.9)	(79.9)	(79.9)	
66		Taxes (assumed at acquirer's rate)			955.4	955.4	955.4	
67		**Total after tax transaction related income/ (expenses)**			**(2,705.3)**	**(2,705.3)**	**(2,705.3)**	
68								
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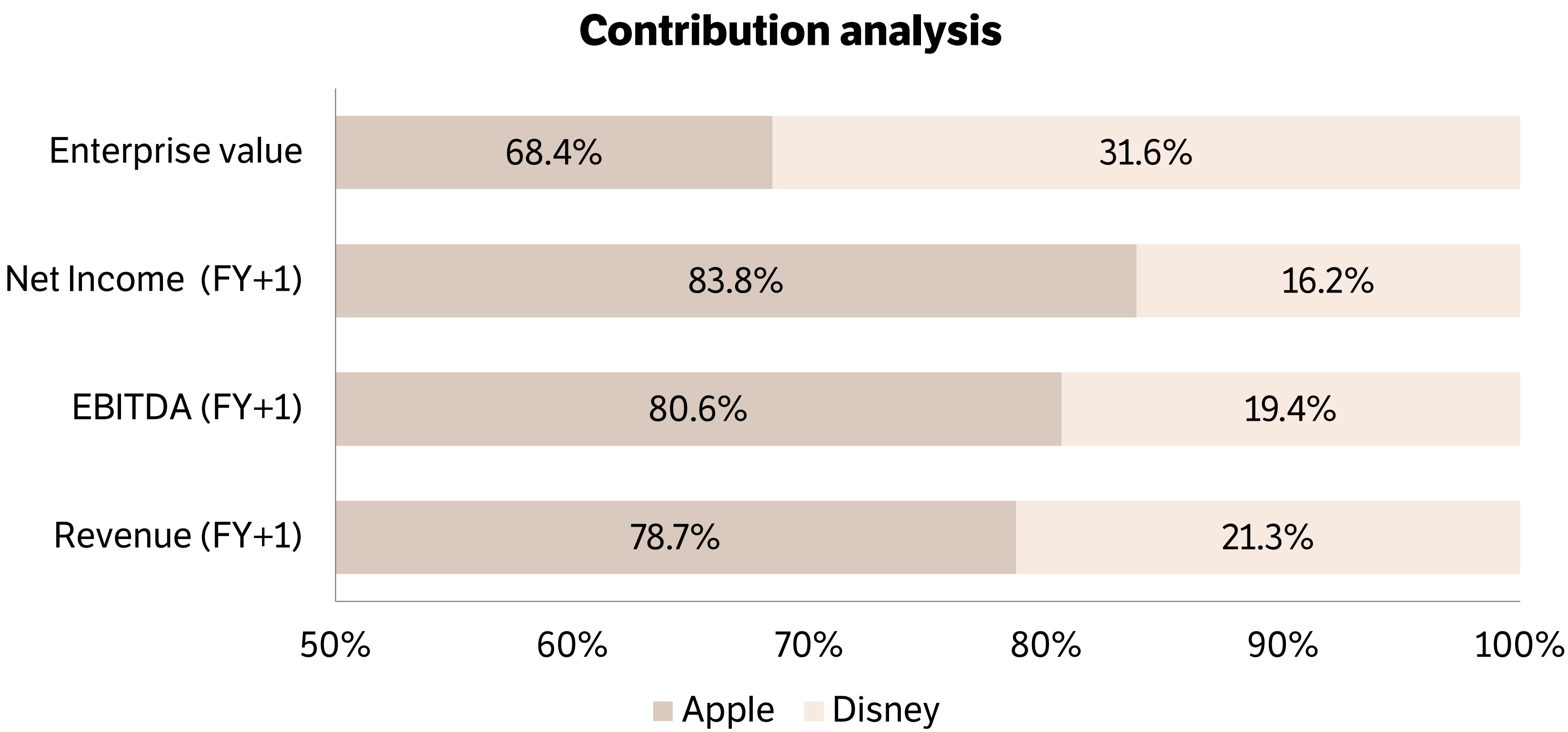
75		Accretion / Dilution %			*(6.0%)*	*(6.3%)*	*(5.8%)*	
76		Additional pretax synergies required to breakeven			3,807.8	4,284.5	4,152.4	
77		[1] One-time charges are excluded from both cash and GAAP EPS calculations in this model						

Contribution analysis

- It is helpful to visualize the financial contributions of both firms to the combined entity:



Implied target valuation via contribution analysis

- Contribution analysis can be expanded to arrive at a contribution-derived target valuation. See the fact pattern:

- Acquirer is contributing 80% of the revenue and has an EV of $800

Contribution analysis exercise	
Acquirer expected revenue	$400m
Target expected revenue	$100m
Acquirer enterprise value (EV)	$800m
Target implied EV	?

- By assuming target revenue is valued the same way as acquirer revenue[1], we can arrive at an implied target EV:
  - Pro forma EV = $800m / 80% = $1,000m
  - Target EV = $1,000m - $800 = $200m

(1) Most deals involve buyer and seller with different multiples. This contribution-based valuation ignores differences between buyer and seller valuation to answer the question: If seller had the same multiple as the acquirer, what would the value of the target be then? This is the central mechanism in this analysis.

Implied target valuation via contribution analysis

- Using the fact pattern in the prior slide, we can also arrive at the implied target share price:

Contribution analysis exercise	
Acquirer expected revenue	$400m
Target expected revenue	$100m
Acquirer enterprise value (EV)	$800m
Implied PF EV	$1,000m
Implied target EV	$200m
Additional info	
Target shares outstanding	180m
Target net debt	$20m
Implied target equity value	?
Implied target share price	?

Congratulations!

Learn more online:

- Modeling Contribution Analysis
- Fixed vs. Floating Exchange Ratios